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No. 770

Supreme Court of the United States

OCTOBER TERM, 1959

ROBERT K. MAYO, H. E. HARPER AND JACK C. MURRELL, AS TRUSTEES IN BANKRUPTCY OF TWIN CITY CONSTRUCTION COMPANY, INC., BANKRUPT,

Petitioners

versus

PIONEER BANK AND TRUST COMPANY

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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February, 1960

LECOMTE, SHREVEPORT, LOUISIANA

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Petitioners, Robert K. Mayo, H. E. Harper and Jack C. Murrell, as Trustees in Bankruptcy of Twin City Construction Company, Inc., Bankrupt, pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered on September 30, 1959 (R. 503).

OPINIONS BELOW

The original opinion of the United States District Court for the Western District of Louisiana was in memo-

randum form (Appendix p. 1) and is not reported. Subsequently the District Court rendered a comprehensive opinion (Appendix p. 2) which is reported at 168 F, Supp. 503 (1958). The opinion of the Court of Appeals for the Fifth Circuit (Appendix p. 37) is reported at 270 F. 2d 823 (1959). A further opinion of the Court of Appeals (Appendix p. 58) denying rehearing is as yet unreported.

JURISDICTION

The judgment of the Court of Appeals is dated and was entered September 30, 1959 (R. 503). Petition for rehearing filed October 19, 1959 (R. 504) was denied January 20, 1960 (R. 556). The jurisdiction of this Court is invoked under 28 U.S.C 1254 (1).

QUESTIONS PRESENTED

The case below consisted of three parts which were for convenience called the $50,125.00 claim, the $9,000.00 claim and the $10,020.00 claim. Your petitioners prevailed below on the $10,020.00 claim and no review of it is sought. The $9,000.00 claim for purposes of this petition is now reduced to $4,398.69. The Trustees sought recovery of the $50,125.00 item and the $4,398.69 item on the basis that these amounts constituted transfers by the bankrupt corporation to the defendant that were constructively fraudulent and voidable under the provisions of 11 U.S.C. 107d (2) (b) The court below held that the Trustees' action insofar as these items are concerned

failed for the reason that the bankrupt had received "fair consideration" within the meaning of 11 U.S.C. 107d (2) (b).

The following questions are presented:

1. When a transfer of money or credits is made by a corporation to a creditor of its sole stockholder in payment of a debt of such stockholder, does the corporation receive "fair consideration" for the transfer within the meaning of 11 U.S.C. 107d (2) (b)?

(a) Can a court, not only as a matter of statutory construction, but as a matter of constitutional law, hold that a bankrupt does receive fair consideration under the above circumstances when its major premise in so holding is that the sole stockholder and the corporation are not separate legal entities, when the positive law of Louisiana is express that such a corporation is a separate legal entity, and when bankruptcy and the rights of creditors of the corporation have intervened.

2. As to the $4,398.69 item, the further question is presented: When a transfer is made from the bank account of a corporation to the bank account of its sole stockholder in defendant bank, which transfer covers an overdraft of such stockholder, is the court below correct in holding that the defendant bank is protected by Section 9 of the Uniform Fiduciary Act, Louisiana Revised Statutes 9:3809, and in refusing to follow the holding of the District of Columbia Court of Appeals in the case of *Colby v. Riggs National Bank*, 92 F.2d 183 (1937), which is squarely in favor of your petitioners?

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

11 U.S.C. 107d (2):

"Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition initiating a proceeding under this title by or against him is fraudulent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent; or (b) as to then existing creditors and as to other persons who became creditors during the continuance of a business or transaction, if made or incurred without fair consideration by a debtor who is engaged or is about to engage in such business or transaction, for which the property remaining in his hands is an unreasonably small capital, without regard to his actual intent; or (c) as to then existing and future creditors, if made or incurred without fair consideration by a debtor who intends to incur or believes that he will incur debts beyond his ability to pay as they mature; or (d) as to then existing and future creditors, if made or incurred with actual intent as distinguished from intent presumed in law, to hinder, delay, or defraud either existing or future creditors".

11 U.S.C. 107d(1)e:

"Consideration given for the property or obligation of a debtor is "fair" (1) when, in good faith, in exchange and as a fair equivalent therefor, property is transferred or an antecedent debt is satisfied, or, (2) when such property or obligation is

received in good faith to secure a present advance or antecedent debt in an amount not disporportionately small as compared with the value of the property or obligation obtained."

With reference to Question 2 only, the following statutes of the State of Louisiana are relevant but because of their length they are set forth in full in the appendix at pages 64-70.

Louisiana Revised Statutes §§9:3801-3814 which is also known as the Uniform Fiduciaries Act.

Louisiana Revised Statutes §7:185 and §7:126.

STATEMENT OF THE CASE

This action originated in the United States District Court for the Western District of Louisiana with that court sitting as a court of bankruptcy, as provided by 11 U.S.C. §1 and §11, and was tried to the court without a jury.

A cause of action is created under the terms of 11 U.S.C. 107d(2) for certain transfers by a bankrupt within one year of bankruptcy which are labeled by the statute as fraudulent. Jurisdiction is granted both to courts of bankruptcy and the appropriate state courts concurrently to entertain actions seeking to set aside transfers allegedly fraudulent under the act. (11 U.S.C. 107e).

This action was brought by the Trustees in Bankruptcy of Twin City Construction Co., Inc., (hereinafter

called Twin City), a Louisiana corporation, to recover certain assets of the bankrupt and return them to the bankrupt's estate for distribution to its creditors.

With reference to the $50,125.00 item the facts are: In May of 1955, William A. Gray was and had been doing business for several years under the trade name W. A. Gray Construction Company. His contracts had consisted primarily of U. S. Government construction at various installations. During the month of May 1955, Gray temporarily was unable to get a performance bond written with his previous bonding company. To resolve this impasse, he decided to reactivate Twin City, a corporation which he owned and which had been without substantial assets and dormant for several years. In order to obtain a performance bond for Twin City, Gray embarked upon this series of transactions: On May 28, 1955, Gray borrowed $50,000.00 on his personal note from the Pioneer Bank and Trust Company, defendant here (hereinafter called "the bank"). The proceeds of this note and $150.00 in cash were deposited in the bank in Twin City's name. This was a new account opened at that time.

This loan was without specific security and was not an obligation of Twin City. Simultaneously with the borrowing of this money, the Board of Directors of Twin City passed various resolutions, one of which authorized the issuance of 495 shares of the corporation stock for cash. This stock was issued to Gray. The capital account was thus balanced to reconcile it with assets and cash on hand.

Immediately after borrowing the money, Gray ordered an audit from a firm of certified public accountants. The bank furnished the auditors with a statement in writing that Twin City had on deposit $50,150.00 and owed the bank nothing. At this time Gray undertook to get a performance bond for Twin City through J. S. Parker Insurance Agency, agent for the Home Indemnity Company. In connection therewith, Gray submitted the CPA's audited report of Twin City's status which reflected unencumbered working capital of approximately $50,000-00, and no debts. Before the bond was issued, but subsequent to the aforesaid certified audit, Gray negotiated on June 9, 1955, directly to the bank a check of Twin City, signed by him as its president, for $50,125.00 post-dated June 12, 1955, which check was accepted by the bank in payment of Gray's personal note of May 28, 1955, with accrued interest. The status of Twin City's bank balance, as listed by the May ledger sheet, reflected a balance at the end of May of $50,150.00. At the end of June, Twin City had $25.00 in the same account. By this stratagem, Twin City thus engaged to fulfill a contract of approximately $200,000.00 with the U. S. Government with an initial working capital of only $25.00.

Insofar as the $4,398.69 item is concerned, the same statute is involved but the facts are different. Shortly before Twin City defaulted on its contract, it borrowed $10,000.00 from the bank on December 29, 1955. By verbal order of Gray, $9,000.00 of this money was transferred to Gray's personal account in the bank. At that time Gray, personally, was overdrawn in the amount of

$4,398.69, and it is the Trustees' contention that to the extent of the overdraft, the bank was a transferee without fair consideration, since money of Twin City had again been used to pay the debt of its sole stockholder with Twin City, itself, receiving no benefit therefrom.

With reference to the $4,398.69 item, it is further contended that under the provisions of the Uniform Fiduciaries Act, L.S.A.-R.S. §9:3812, which makes the common law rule of liability applicable to facts not specifically covered by the act, the bank is liable for the using of funds of the bankrupt to cover an overdraft in the personal account of the bankrupt's president.

REASONS FOR GRANTING THE WRIT

I

In deciding that the payment of a sole stockholder's personal debt is "fair consideration" to a bankrupt corporation within the meaning of 11 U.S.C. 107d(2), the Court below erroneously decided an important question of federal law involving the bankruptcy statutes which has not been, but should be, settled by this Court.

The Trustees' claim for the $50,125.00 item and for the $4,398.69 item is based upon the provisions of 11 U.S.C.A. 107d(2)(b), which provides that certain transfers are fraudulent if made without "fair consideration" and are thus voidable by the Trustees. The bank in this case received payment of the sole stockholder's personal debts from the corporation, Twin City, which is now a

bankrupt. The creditors, through the Trustees, seek to recover those amounts.

The court below conceded (R. 484, App. p. 42): "There is no doubt that usually a diversion of corporate assets for the benefit of a third person, such as the payment of the loan of another is a transfer without 'fair consideration'. This however is not the usual case."

It is not just the diversion of corporate assets for the debt of a third person that is not "fair consideration" but even the payment by an individual of the debts of another individual is not fair consideration to the payor. The statute in question is known most popularly as the "Chandler Act" and is virtually a verbatim copy of the Uniform Fraudulent Conveyances Act. This latter act has been on the books of many states for almost four decades, and its copy, the Chandler Act, has been a federal statute for more than two decades. Most of the following cases were decided under the Uniform Fraudulent Conveyance Act, however, because of the history of the federal statute, we consider them equally good authority as an aid to this Court in correctly interpreting the legislation in question.

The following cases support the position of the Trustees herein:

Barr, et al. v. Zoller, 109 F. 2d 924 (1940) involving payment by a bankrupt subsidiary corporation of the debt of its parent corporation.

In re Venie, et al, 80 F. Supp. 250 (1948) involving transfer of partnership property to a bank as security for the debt of one of the partners.

Bennett v. Rodman & English, 2 F. Supp. 355 (1932) which involved payment by one bankrupt corporation of the debts of a second corporation, the two corporations having a common owner.

Davis vs. Hudson Trust Co., 28 F.2d 740 (1928) (cert denied, 49 S. Ct. 179, 278 U.S. 655, 73 L.Ed. 565). A wife executed a mortgage for her husband's debts. The transfer was set aside for lack of fair consideration.

In accord are:

Hansen vs. Cramer, (Supreme Court of California) 245 P. 2d 1059 (1952).

Hollander v. Gautier, 168 A. 860 (N.J. 1933)

Merchant's Bank v. Page, 128 A.272 (Md. 1925), holding reaffirmed and approved, *Kline v. Inland Rubber*, 69 A.2d 774 (Md. 1949).

Newmeyer v. Weinburger, 295 N.W. 775 (Wisc. 1941).

The leading text, Collier on Bankruptcy, is also in agreement with the position of Trustees.

"Transfers made to benefit third parties are clearly not made for a 'fair' consideration. Thus it has been held under the Uniform Act (Uniform Fraudulent Conveyance Act) that a conveyance made by a wife to save her husband from criminal

prosecution is not fair to her creditors. Section 67d(4) is explicit in respect to partnerships by requiring fair consideration to the partnership as distinguished from consideration to the individual partners. No more should a conveyance by a corporation for the benefit of an affiliate be regarded as given for fair consideration as to the creditors of the conveying corporation." Collier on Bankruptcy (14 Ed.) Vol. 4, page 355.

Neither counsel for defendant in brief, nor the court below in its opinion, cited a single case under either the Chandler Act or the Uniform Fraudulent Conveyance Act in support of the court's decision.

With this mass of authority in favor of the Trustees, why did the court below hold contra? Is a sole stockholder of a corporation more of a unity with that corporation than a wife is to her husband, a partner to a partnership, a corporation to its subsidiary corporation? We submit that such a holding is unthinkable.

The primary reason behind the court's holding seems to be what is found to be the "good faith" of the bank. The officers of the bank testified they had no knowledge of stockholder's scheme to deceitfully acquire a performance bond. If such is the court's holding, it is placing a burden on the Trustees that Congress did not see fit to place upon them by the statute. Good or bad faith on the part of the transferee (bank) is not an essential of a cause of action under the act. If the transfer was without fair consideration, then the last requirement of the act has been met. One thing is certain, the bank did know that the money came from Twin City as the check

was drawn on Twin City's account and it further knew that Twin City's sole stockholder's debt was being discharged as it then cancelled, marked paid and returned to him his note for $50,000.00.

Further, at that time, the bank did not claim that Twin City owed it this money as it had less than two weeks previously given a statement in writing to the C.P.A.'s making the audit, that Twin City had $50,150.00 on deposit and did not owe the bank anything. (P-38) Resolutions of Twin City authorizing its sole stockholder to sign checks are not the solution. A resolution can only give to the check signer the maximum authorization of the corporation, but the corporation is unable to legally authorize anyone to dispose of its assets without fair consideration. We have cited cases dealing with individuals and certainly a resolution can give to an agent of a corporation no more authority than an individual inherently has to deal with his own assets. Intellectually, the court below realized that the great weight of authority is against its decision, so to make the opinion consistent, rationally, if not legally, the court held that for the purposes of the transaction with the bank, the sole stockholder and Twin City were not separate legal entities. This premise is based upon unconstitutional reasoning, which we shall now discuss.

I (a)

The holding of the Court below that, insofar as the bank was concerned in its transactions with Twin City, Twin City and its sole stockholder were without separate legal identity is an unconstitutional merger of identities and is contrary to the decisions of this Court, and contrary to the laws of Congress.

Let us examine the holding of the Court below that "the facts justified disregarding the fiction that Twin City was a separate legal entity". A corporation is sometimes referred to as a fiction but one thing is certain, it is no fiction that corporations are separate legal entities.

The Louisiana Corporation Act provides (Louisiana Revised Statutes 12:12):

> "A corporation which has been formed under this Chapter or a corporation which existed on January 1, 1929 and of a class which might be formed under this Chapter, shall have the capacity to act possessed by natural persons, but such a corporation shall have authority to perform only those acts which are necessary or proper to accomplish its purposes as expressed or implied in the articles or that may be incidental thereto, and which are not repugnant to law."
>
> * * * * * *
>
> "Contract, sue, and be sued in its corporate name."

The record is clear that Twin City was duly incorporated, properly in existence, and a separate legal entity under the laws of Louisiana. It can not be held

liable for acts of others; only for acts and contracts of its own. To hold that this corporation is not a separate legal entity is a refusal to apply the substantive law of Louisiana in direct contravention of *Erie Railroad v. Tompkins*, 82 L. Ed. 1188, 304 U.S. 64:

> "Except in matters governed by the Federal Constitution or the Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern."

28 U.S.C. 1652 provides:

> "The laws of the several states except where the constitution or treaties of the United States or Act of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in courts of the United States, in cases where they apply."

This action was not required to be filed in a Federal Court. Concurrent jurisdiction lay also with the appropriate state court. (11 U.S.C. 107e) If the holding that the sole stockholder and Twin City are not separate legal entities becomes final, the undesirable situation posed by the *Erie Case*, supra, of result depending on the forum follows. There can be no doubt that a Louisiana court, considering the corporate statutes quoted, and the proof of Twin City's proper incorporation, as shown by the record, would hold the legal indentities separate. It is interesting to note that the court below merged the identities only for purposes of upholding the transactions with the bank. What of the creditors of Twin City? The

principal creditor of Twin City issued a performance bond for a contract with the Federal Government relying upon its belief that Twin City had $50,150.00 cash working capital. Although the bonding company did not have a right to supervise the spending of this money, it did have the right to see that it was expended for corporate purposes. It had a right at the time it wrote this bond, if bankruptcy should intervene, to recover all assets of the corporation which had been disbursed within one year without the bankrupt estate receiving a fair value therefor. The government contract here was made, not with the stockholder, but with Twin City. Not one person dealing with Twin City treated it as having no legal identity of its own. This is particularly true of the bank. The money the stockholder borrowed was deposited in an account entitled "Twin City Construction Co., Inc." and the bank would not honor checks drawn by the stockholder on that account unless he had a resolution from Twin City authorizing him to so act. If the bank had considered the identities to be one and the same the stockholder would have needed no special authority from Twin City to cash checks. In fact the identities did not merge until the opinion of the court below melded them.

Further, even if the Erie case did not so demand and instead a Louisiana court attempted to hold several years after incorporation, in a matter of creditor's rights, that a corporation duly incorporated is not a separate legal entity, such a decision would be in direct violation of the 14th amendment of the United States Constitution and a taking of property without due process of law. In its opinion refusing rehearing, the court below cited for

the first time two Louisiana cases, Keller v. Haas, 1943, 202 La. 486, 12 So. 2d 238, and *Linstrom v. Sauer*, 1936, La. App., 166 So 636. These cases hold a stockholder liable for his acts on behalf of a corporation. It is hornbook law that an agent who commits a tort or fraud is liable personally along with his principal. The cited cases involve that, and nothing more, and have nothing whatsoever to do with merging of legal identities, or the holding of a corporation for the debt of its sole stockholder, where the corporation has made no representations to the creditor. Other Courts when urged, have refused to merge the corporate identity with sole stockholder in prejudice of corporate creditors.[1] The bankruptcy act itself recognizes the separate identity of corporations. "Persons" is defined to "include corporation" (11 U.S.C. 1 (23) and it further provides "Any person" may become "a voluntary bankrupt." The latter section further provides "Any natural person . . ., and any moneyed, business, or commercial corporation . . . may be adjudged an involuntary bankrupt . . ." (11 U.S.C. 21). Twin City in the instant case was an involuntary bankrupt. It is grossly inequitable to hold that Twin City has a separate identity as to its own creditors, and merge its identity to its sole stockholder for the purpose of upholding a transaction for the benefit of the sole stockholder. The court below asserted power to merge the identities by saying it was "exercising the traditional equity powers of a court of bankruptcy". This view is incorrect for two reasons. First, this is a statutory

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(1) *Carozza v. Federal Finance & Credit Co.*, 131A. 332. *Continental Securities Investment Co. vs. Rawson*, 208 Cal. 228 280 P. 954 *In re Collins*, 75 F. 2d 62.

action at law to which the bankruptcy court is given jurisdiction along with the state courts and, secondly, equity for the past three hundred years has had as rigid a set of rules circumscribing its actions as courts of law have, and this partial merger of identities by the court fits into none of the equitable causes of action. Equity does not have an unfettered right to disturb legal relationships firmly established in law and in practice.

II

Insofar as the $4,398.69 item is concerned, the decision of the Court below is diametrically opposed to the decision of the District of Columbia Court of Appeals in the case of Colby v. Riggs National Bank, 92 F. 2d 183 (1937) and this Court should resolve the differences.

This item involved the transfer of $9,000.00 from Twin City's bank account to that of Gray, sole stockholder, upon the verbal order of sole stockholder Gray evidenced by a debit memorandum issued by the bank. At the time of transfer sole stockholder Gray was overdrawn in the sum of $4,398.69 and this transfer canceled the overdraft.

The Common Law of trusts applies to this transaction unless the bank can find relief under the Uniform Fiduciary Act L.R.S. 9:3801:14 (App. 64-70). The court below did so find. Before doing so, in interpreting the statute, the court below first held that a "verbal order" and a "check" were interchangeable, saying:

> "Similarly, for purpose of Section 9, we see no difference between giving a check to a bank in pay-

ment of a personal indebtedness (or depositing a check in an overdrawn account) and giving an order, for record purposes cast in the form of a debit memorandum, to a bank to deposit funds in an overdrawn account." (R. 554, App. p. 62).

It is clear under Louisiana law that an oral order evidenced by debit memorandum is neither a check nor a bill of exchange. L.R.S. 7:185, 7:126. (App. p. 70) To so hold is an unjustified construction of the word "check" as used in the statute.

Assuming arguendo that the transaction is for all purposes similar to the deposit by a fiduciary in his personal account which is overdrawn, of a check drawn by the fiduciary on his trust account, the decision below is in direct conflict with *Colby v. Riggs National Bank*, 92 F. 2d 183 (1937).

The assumed facts and the facts in the Colby Case on this point are the same. The court said at page 198:

"The incidental result of this transaction was the payment of the overdraft then standing on the books of the Bank against Swartzell Company; but the payment thus effected was not the result of a negotiable instrument transaction but was the result rather of a bookkeeping arrangement of credits and debits. The act has for its purpose the facilitation of commercial transactions in negotiable instruments."

And further on page 198 the court says:

"Since the transaction is not covered by the statute, it comes within the scope of Section 12, which provides that in such a case the recognized

rules of law and equity relating to trusts shall continue to apply. Under these rules the Bank cannot escape from the liability to account for the amount of the trust fund received by it in payment of Swartzell Company's overdraft."

The court below refused to follow the Colby Case, supra, saying: "We feel the dissent expresses the better view." (App. p. 51, R. 494). It is the Trustees' position that the holding of *Colby, supra*, is the better view. At any rate, this court should determine for the guidance of all concerned the proper holding in this case.

RECAPITULATION

Private industry and the Federal Government spend vast amounts of money on construction contracts each year. Most of industry and the government, as required by law, require performance bonds from their contractors. Until the decision of the court below, bonding companies, in the event of bankruptcy of the contractor, had a right to require both corporate and individual bondees not to dissipate their capital without receiving something in return. If the decision of the court below is permitted to stand, a shadow has been cast across the rights of this class of creditors, and by the court's unique theory of a partial merger of legal identity, confusion is thrown into this vast area of activity.

Respecting the payment of the overdraft, the Trustees rely upon a decision by the Court of Appeals for the District of Columbia. The court below has categorically rejected the holding of that court. When such

an impasse occurs, the injured litigant must perforce ask this Court to select the correct view.

The entire case calls for and requires the proper interpretation and application of the Bankruptcy Statutes of the United States. The statutes, in their present form, are relatively new, so new, in fact, that the Supreme Court of the United States has not to this date considered them, nor had an opportunity to do so and announce their proper application.

It is important, not only in the present case, but in every bankruptcy case, that these statutes, as a matter of national importance, be construed by the Supreme Court and the correct application of them be settled for the future guidance of subordinate courts and so that business men and industry can, with some degree of safety, have before them a fixed and stable blue print.

It is respectfully submitted that a writ of certiorari be granted.

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February, 1960.

APPENDIX

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IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

* * * * * * * * * * * * * * * * * *

CIVIL ACTION
No. 5516

W. T. MAYO, H. E. HARPER and JACK C. MURRELL,
TRUSTEES IN BANKRUPTCY OF
TWIN CITY CONSTRUCTION COMPANY, INC.

vs.

PIONEER BANK & TRUST COMPANY

* * * * * * * * * * * * * * * * * *

BEN C. DAWKINS, JR., CHIEF JUDGE

MEMORANDUM RULING ON MERITS

Over a period of several months we have studied this complicated case in all of its aspects.

Having reviewed the evidence; having read and re-read the voluminous briefs; and having studied the authorities relied on by the parties, we are convinced that defendant's counsel have correctly argued the facts and controlling law in their several briefs, and that all of the claims by plaintiffs against defendant are legally and equitably without merit. Accordingly, we conclude that there should be judgment in favor of defendant, rejecting plaintiffs' demands in their entirety.

If time would permit, we would expound our views in a detailed, narrative opinion. However, our Trial Calendar is full, with thirty-three civil cases (including consolidations) set for trial at Shreveport during October, with an equal number to be disposed of at Monroe during November and early December. In the meantime, we have a Calendar of criminal cases to try, plus several

other matters specially fixed, as well as motion and pre-trial proceedings arraignments and matters of that kind.

Consequently, we must call upon defendant's Counsel for help; and they should submit for our consideration, within sixty days, detailed suggested Findings of Fact and Conclusions of Law, which, after study and conformance to our exact views, we shall enter and file of record.

THUS DONE AND SIGNED, in Chambers, at Shreveport, Louisiana, on this the 16th day of September, 1958.

/s BEN C. DAWKINS, JR.
UNITED STATES DISTRICT COURT

Filed September 16, 1958
Alton L. Curtis, Clerk

IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF LOUISIANA
SHREVEPORT DIVISION

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CIVIL ACTION No. 5516

W. T. MAYO, H. E. HARPER and JACK MURRELL,
TRUSTEES IN BANKRUPTCY OF
TWIN CITY CONSTRUCTION COMPANY, INC.

vs.

PIONEER BANK & TRUST COMPANY

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BEN C. DAWKINS, JR., CHIEF JUDGE

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause having been submitted for decision, by the Court without a jury, the Court having considered the pleadings, the stipulations of counsel, the exhibits, the testimony of the witnesses, and the briefs of counsel, hereby makes and enters the following Findings of Fact and Conclusions of Law, pursuant to Rule 52(a), Fed. Rules Civ. Proc.:

This is an action by the Trustees in Bankruptcy of Twin City Construction Company, Inc., against Pioneer Bank & Trust Company of Shreveport, Louisiana, seeking to recover the total sum of $69,145.00 alleged to have been received by defendant and claimed to be voidable transfers under Sections 60(b) and 67(d) of the Bankruptcy Act. The items sought to be recovered logically and conveniently should be placed in three separate categories as to which separate Findings of Fact and Conclusions of Law will be entered. They are as follows: (1) A claim for $50,125.00; (2) another for $9,000.00; and, (3) still another for $10,020.00. Preliminary to summation of the detailed facts and a statement of our particular con-

clusions of law, the following general background statement is made for a clearer understanding of the nature of this proceeding:

GENERAL STATEMENT

An involuntary petition in bankruptcy was filed against W. A. Gray, d b a W. A. Gray Construction Company, on March 12, 1956, in proceeding No. 7729 on the Bankruptcy Docket of this Court. Thereafter, on March 21, 1956, he was adjudicated a bankrupt upon his voluntary petition. He died on May 7, 1956. An involuntary petition was also filed against Twin City Construction Company by the Home Indemnity Company on the 13th day of April, 1956, in proceeding No. 7751 on the Bankruptcy Docket of this Court, and on April 21, 1956, Twin City Construction Company voluntarily was adjudicated a bankrupt. Gray was the sole stockholder of Twin City Construction Company and to a large extent, during the times in question, commingled the affairs of that corporation with his individual business.

William Alton Gray for many years had engaged in the construction business under the name of W. A. Gray Construction Company. Outwardly, he appeared to be quite successful. Whatever financial difficulties he had, he was able successfully to cover up and surmount until January, 1956, when he concluded he could not continue in business.

When Pioneer Bank & Trust Company was organized in 1945 and opened for business, Gray became one of its depositors and customers. (R. 274, 276.) In the regular course of business, the Bank made many loans to Gray to finance his construction business, permitting him to start and carry forward individual construction contract (see Exhibit D-15, listing Bank loans to Gray back to 1950.) Throughout its course of dealings with

Gray, and until January of 1956, the Bank had never sustained any loss on any loan made to him individually or to his business, W. A. Gray Construction Company (R-277). The account was handled by the Bank's President, Rupert Campbell, who approved loans, (R-235), clearing such matters with the Discount Committee when necessary. It is apparent that those who did business with Gray had utmost confidence in his ability to meet his financial obligations. This included Home Indemnity Company, whose representative testified that he was willing to and did authorize the writing of the bond here involved, if Gray would give his personal indemnity (R-100). The Bank, in discussing various loan transactions with him, repeatedly asked for financial statements, which were not furnished, but his record of payment through the years was good and this request was not pressed. The Bank considered that the general securities it held were adequate to protect its loans.

The bonding company's representative, Mr. Scott, was much impressed with Mr. Gray's physical plant in June of 1955. The personal financial statement, introduced as Exhibit P-2, furnished to the bonding company at that time, was entirely satisfactory on its face. It showed a net worth of $293,952.45, but this did not accurately reflect the true situation.

Gray's affairs thus appeared outwardly to be not only solvent, but prosperous, to those with whom he dealt. His true financial status, however, as described by his office Manager, Preston Petty, presents an entirely different hindsight picture. Mr. Petty testified that if Mr. Gray had been forced to liquidate at any time after 1951, he would have been insolvent. Petty also testified as to the procedure followed by Gray so as to keep the Bank from learning of his true financial status (R-174, 175, 176). He also described how Gray would borrow and pay

back and borrow again (R-176), always saying that they had worked out of a bad capital situation once and could do it again, e. g., "It may take four or five years, but we will pay out again." (R-147.) Petty also testified that Gray had no intention of ever "beating" anyone out of anything, but had to have capital and bonds and would do what it took to get a bond (R-147). Just prior to the collapse of his operations in January of 1956, Gray had as many as ten large government construction contracts going on in the State of Arkansas (R-191). He had money coming in on these government contracts and, undoubtedly, hoped to utilize the profits to recoup his negative capital situation.

As stated the true capital condition known to Petty and Gray obviously was not communicated to the Bank (R-174-176). Gray had established a line of credit at the Bank, had posted collateral mortgages and pledges to secure loans to be made to him, and, in addition, when loans were made on individual contracts, a pledge was taken by the Bank covering the proceeds of the individual contract on which the loan was made (see Exhibit D-9, Pledge Agreement on $19,000 loan and, Exhibit D-10, Pledge Agreement on $10,000 loan). The Bank held as general collateral security a $40,000 mortgage on Gray's home, a $20,000 mortgage on his office building, a $20,000 mortgage on his equipment, a pledge of the stock of W. A. Gray, Inc., owner of the property known as Blair Apartments (R-209).

This shows the apparently substantial character of Gray's business and account with the Bank and justified the course of dealing and confidence the Bank's President had in him (R-210). His line of credit was such that the Bank, in the normal course of business, frequently honored payroll and material checks, and other withdrawals, even though overdrafts often occurred, (see Testimony of Mr. Friedman, R-251, 252).

1. THE $50,000.00 LOAN TO W. A. GRAY AND ITS REPAYMENT

FINDINGS OF FACT

1.

Twin City Construction Company, Inc., was organized in 1951. William A. Gray was the sole stockholder. This corporation had been dormant and conducted no business as such for several years (R-219).

2.

On May 28, 1955, Gray approached the Bank, through Mr. Campbell, and requested a loan of $50,000.00, stating that he had decided to reactivate Twin City Construction Company and that he thereafter was going to conduct his construction operations through Twin City Construction Company, Inc. In support of this request, Gray stated that his health had been poor and that he desired to do business on construction contracts in the corporate form to insure continuity and to avoid personal liability (R-220). He also stated that he expected to obtain additional capital from another party who had expressed a desire to enter the construction business with him (R-220). The evidence established that similar statements were made by Gray to representatives of the Home Indemnity Company when Gray made application for a bond on a construction contract at Blytheville, Arkansas, which was eventually awarded by the United States Government to Twin City Construction Company (see testimony of Mr. Scott, R-100).

3.

Pioneer Bank & Trust Company, at Gray's request, and relying upon his representations and upon its long continued course of satisfactory banking relations with

him, made a loan of $50,000.00 as requested on May 28, 1955. The Bank took Gray's personal note for that amount, payable in fifteen days, to its own order (Exhibit P-). The entire $50,000.00, at Gray's direction, was deposited simultaneously by the Bank in the checking account of Twin City Construction Company, Inc., maintained at Pioneer Bank (Exhibit P-4). Deposit slip dated May 28, 1955, in the amount of $50,150.00 was stipulated at the trial to include this $50,000.00. When this was done, the Bank held collateral mortgages on Gray's office and yard property, a $40,000.00 mortgage on his home and a pledge of all of the capital stock of the Blair Apartments.

4.

Pioneer Bank & Trust Company, through the $50,000.00 loan, in fact augmented the funds of Twin City Construction Company *pro tanto*. At no time was this sum, or any part of it, withdrawn from the bank account prior to its repayment to the Bank on June 8th or 9th, 1955, as hereinafter related. The sum of $50,125.00 which the Trustees seek to recover in this action is in fact the identical $50,000.00 constituting the proceeds of the loan referred to. But for the loan of $50,000.00 made by the Bank as above related, there would have been no asset or credit item in that amount reflected in the bank account of Twin City Construction Company, Inc.

5.

On the 8th day of June, 1955, Gray reported to the Bank that the purpose for which the loan had been made could not be carried out; and the transaction was closed by repayment of $50,125.00 to the Bank by check signed by Gray as President of Twin City Construction Company payable to the Bank, (Exhibit P-6), covering the principal

and accrued interest. The check was dated June 12, 1955, but actually was cleared on June 9, 1955. The issuance of the check by Gray in payment of the loans was in practical effect a reversal of the bookkeeping entry under which the $50,000.00 had been credited to the account of Twin City Construction Company, the entire transaction consuming only twelve days. Thus it is found as a fact that, within a period of only twelve days, the loan was made, the funds were credited to Twin City, the Bank was told the purpose was impractical and the exact money loaned was repaid to the Bank which had furnished it prior to its withdrawal. There can be no question as to Gray's authority to represent Twin City Construction Company, through proper board resolutions, in all of its transactions with the Bank, (see Exhibits D-2, D-3, D-4), which in fact acted in good faith.

6.

Gray apparently issued stock to himself in Twin City Construction Company for $50,000.00, but the Bank was unaware of this at the time of the transaction. When it suited his purposes, Gray showed the stock to have been issued to himself. The Court finds as a fact that the Pioneer Bank & Trust Company had no knowledge of the issuance of the stock until a considerably later date, and knowledge thereof is not chargeable to the Bank during the period in question. We further find as a fact that the Bank had no knowledge of any intention that Gray may have had to issue $50,000.00 in stock to himself in return for the proceeds of the loan.

7.

Prior to June 15, 1955, Gray had made application, on behalf of Twin City Construction Company, to Home Indemnity Company for a Contractor's Performance Bond. On June 15, 1955, which was about a week after

the $50,000.00 loan had been repaid to the Bank, Home Indemnity Company sent its representative, Mr. Scott, to Shreveport for the purpose of investigating the application. Mr. Scott called at the Pioneer Bank with a Mr. Parker, one of the Home's local agents. From Scott's own testimony it is clear and undisputed that he asked the Bank for verification of the $50,000.00 balance, as shown in Twin City's financial statement furnished by Gray, as of May 31, 1955, and that the balance of $50,000.00 as of that date was thus verified, by an officer of the Bank who had not handled, and was not familiar with, the details of Gray's or Twin City's accounts. These representatives of the bonding company did not attempt to verify, or even inquire about, whether the $50,000.00 was on June 15, 1955, still on deposit in the account of Twin City Construction Company. This constituted gross carelessness on their part for if inquiry had been made as to the balance on June 15, 1955, the fact that the credit had been withdrawn and paid to the Bank would have been discovered, and undoubtedly the bond would not have been written. The Court finds that Mr. Lindsey was the representative of the Bank who on June 15, 1955, verified the statement as of May 31, 1955, as requested by Scott, and that neither Mr. Lindsey nor any other representative or officer of the Bank was in any way a party to any misrepresentation of any character to the representatives of the bonding company. The bond was not written until the 21st day of June, 1955, after Home Indemnity Company had conducted its own investigation and after it had satisfied itself with the personal guaranty of Gray. Gray also had given Home Indemnity Company the same reasons for converting his activities over to corporate form as he had given to Mr. Campbell, President of the Bank. The Bank was as much deceived by Gray's representations in this respect as was the bonding company.

8.

Pioneer Bank & Trust Company, by letter dated June 9, 1955, (Exhibit P-24), listed all of Gray's personal loans in a letter to Newark Insurance Company, another bonding company reinsuring a portion of the bond, which letter was dispatched late in the afternoon of June 9, 1955, and which was based on information compiled by the Loan and Discount Department of the Bank. The Court finds as a fact that the letter was issued in good faith and reflected the then existing facts under which the $50,000.00 loan had been previously repaid, and for this reason was not included in the list of outstanding loans chargeable against Gray. Gray undoubtedly used the credit balance of $50,000.00 on May 31, 1955, in setting forth assets of Twin City in making application for the bond written by Home Indemnity Company and he further used a financial statement and audit report showing that on May 31, 1955, there was a $50,000.00 bank balance to the credit of Twin City. The Bank was not a conscious party to any of these misrepresentations by Gray, but did furnish routine verification of balances as of May 31, 1955, the only date as of which verification was requested. Gray did not make disclosure to the Bank of any intention he may have had to use the bank balance of Twin City as a credit item to obtain a bond and the Bank was equally deceived by his fraudulent representations as to the intended purpose of the loan in that respect.

9.

The evidence does not support the factual contention made by plaintiffs that a representative of the Bank stated to the representative of the bonding company that there was no note of Gray supporting the $50,000.00 deposit or that the deposit of May 28, 1955, represented personal savings of Mr. Gray and not a loan. In this

respect the Court believes the testimony of the Bank's witness denying that any such representation was made.[1]

10.

During the period when Twin City was activated by the action of Gray, that is, from May 28, 1955, until it was adjudicated a bankrupt on April 21, 1956, it had only one contract, the Blytheville, Arkansas, government contract. Home Indemnity, as its surety, eventually paid bills of Twin City in the approximate amount of $52,130.42 to complete the contract. The record does not establish that Twin City was insolvent as of the date of the repayment of the $50,000.00 loan to the Bank, June 8, 1955, or as of June 22, 1955, when the bond of Home Indemnity Company was written.

CONCLUSIONS OF LAW

1.

Section 67d (6) of the Bankruptcy Act, with exceptions therein noted, annuls, in favor of the Trustees in Bankruptcy, those tranfers which are fraudulent as defined in the Act. The applicable statutory provisions are:

> 67d (6) A transfer made or an obligation incurred by a debtor adjudged a bankurpt under this title, which is fraudulent under this subdivision

(1) Counsel for the trustees in their second reply brief argue: "The Bank, with full knowledge of Gray's shenanigans, informed Mr. Scott, of the bonding company, **before** the bond was written, that the $50,000 deposited in the account of Twin City was not the proceeds of any loan to Gray, knowing full well that it was, being a party, to Gray's depositing the proceeds of the loan made by him to the account of Twin City": (Second Reply Brief, p. 2.) The Court does not accept this conclusion of fact, finding, on the contrary, that the preponderance of the credible testimony is to the effect that the Bank had no such knowledge of Gray's plans and no such misrepresentations were, in fact, made by the Bank.

against creditors of such debtor having claims provable under this title, shall be null and void against the trustee, except as to a bona fide purchaser, lienor or obligee for a present fair equivalent value: Provided, however, that the Court may, on due notice, order such transfer or obligation to be preserved for the benefit of the estate and, in such event, the trustee shall succeed to and may enforce the rights of such transferee or obligee: And provided further, that such purchaser, lienor, or obligee, who without actual fraudulent intent has given a consideration less than fair, as defined in this subdivision, for such transfer, lien, or obligations, may retain the property, lien, or obligations as security for repayment.

* * * * * * *

67d(1)(e) Consideration given for the property or obligation of a debtor is "fair" (1) when, in good faith, in exchange and as a fair equivalent therefor, property is transferred or an antecedent debt is satisfied, or (2) when such property or obligation is received in good faith to secure a present advance or antecedent debt in an amount not disproportionately small as compared with the value of the property or obligation obtained.

2.

As is pointed out *Collier's Bankruptcy Manual*, (Oglebay, Kelliher and Newkirk) (1948), p. 845, in discussing Section 67d:

"Whether a fair consideration has been given for a transfer *must depend on all of the circumstances of the case.* Fairness in every case is largely a question of fact, *as to which considerable latitude must be allowed to the trier of the facts.*"
(Emphasis supplied.)

3.

The Bankruptcy Act defines the terms "debt" and "creditor" in Section 67d (1) as follows:

> "(d) For the purposes of, *and exclusively applicable to, this subdivision:* *** (b) 'debt' is any legal liability, whether matured or unmatured liquidated or unliquidated absolute, fixed or contingent; *** (c) 'creditor' is a person in whose favor a debt exists;" (Emphasis supplied).

4.

Pertinent and applicable articles of the Louisiana Civil Code include the following:

> Article 1896: Cause and want of cause defined.—"By the cause of the contract, in this section, is meant the consideration or motive for making it; and a contract is said to be without a cause, whenever the party was in error, supposing that which was his inducement for contracting to exist, when in fact it had never existed, or had ceased to exist before the contract was made."
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> * * * * * *
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> Article 2292: "Certain obligations are contracted without any agreement, either on the part of the person bound, or of him in whose favor the obligation takes place.
>
> "Some are imposed by the sole authority of the laws, others from an act done by the party obliged, or in his favor.
>
> "The first are such engagements as result from tutorship, curatorship, neighborhood, common property, the acquisition of an inheritance, and other cases of a like nature.

"The obligations, which arise from a fact, personal to him who is bound, or relative to him, result either from quasi contracts, or from offenses and quasi offenses."

* * *

Article 2293: "Quasi contracts are the lawful and purely voluntary act of a man, from which there results any obligation whatever to a third person, and sometimes a reciprocal obligation between the parties."

* * *

Article 2294: "All acts, from which there results an obligation without any agreement, in the manner expressed in the preceding article, from quasi contracts. But there are two principal kinds which give rise to them, to-wit: The transaction of another's business, and the payment of a thing not due."

* * *

Article 2300: "All persons, such even as are incapable of consent, may, by the quasi contract, resulting from the act of a third person, become either the object or the subject of an obligation; because the use of reason, although necessary on the part of the person whose acts forms the quasi contract, is requisite in those by whom, or in whose favor, the obligations resulting from the act, are contracted."

* * *

Article 2301: "He who receives what is not due to him, whether he receives it through error or knowingly, obliges himself to restore it to him from whom he has unduly received it."

* * *

Article 2315: "Every act whatever of man that

causes damage to another, obliges him by whose fault it happened to repair it; . . . ."

5.

Under the provisions of the Bankruptcy Act relied upon by plaintiffs, a transfer within one year prior to the filing of a petition in bankruptcy is not fraudulent unless it is made or incurred "without fair consideration."(2) In light of the statutory definition of fair consideration as that term is used in the Bankruptcy Act above quoted, the Court finds as a conclusion of law that the repayment to the Pioneer Bank & Trust Company of the $50,000.00 loan under the facts and circumstances of this case cannot be said to be "without fair consideration" as that term is used in Section 67d (2) and for this basic reason, in addition to the reasons further stated, an essential element of a voidable transfer is lacking under the Act. The Court also finds that the repayment made to the Bank of the identical bookkeeping credit reflecting the proceeds of the loan never withdrawn was as a matter of law supported by a fair equivalent in value under Section 67d (6) in that the transaction must, under the provisions of law quoted, be viewed in its entirety and in its net effect. In applying these provisions of the Bankruptcy Act this Court must consider the fact that the Bank was repaid the identical money it had furnished to Gray in the Twin City account. If Gray had not repaid the Bank but had revealed the facts to it, there would have been a legal obligation on the part of Twin City

(2) "Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition initiating a proceeding under this title is fraudulent * * * (b) as to the then existing creditors and as to the other persons who became creditors during the continuance of a business or transaction, if made or incurred without fair consideration by a debtor who is engaged or is about to engage in such business or transaction, for which the property remaining in his hands is an unreasonably small capital, without regard to this actual intent; * * *." § 67d (2) (b), 11 U.S.C.A. 707 (d) (2) (b). (Underlining supplied.)

to make the reimbursement. In other words, the circumstances under which the loan was made were sufficient under the law of Louisiana to give rise to an antecedent indebtedness from Twin City Construction Company to the Bank. Such liability on the part of Twin City properly may be predicated either upon the principle of quasi contract (unjust retention of a benefit) or delictual responsibility. See the Civil Code Articles above cited.

Though the facts establish that the loan was initially made on the credit of Gray, the proceeds inured only to the benefit of Twin City and the loan was made for a specific and definite purpose, to-wit: to enable Gray thereafter to carry out his construction business as Twin City Construction Company instead as W. A. Gray Construction Company. The purpose for which the loan was made having failed, according to the representations made by Gray to the Bank, and accepted by the Bank in good faith, established, under the quoted Articles of the Louisiana Civil Code, a legal right in the Bank to demand reimbursement from Twin City of the proceeds of the loan. If the Bank had the legal right to compel Twin City to make reimbursement when Gray stated the purpose of the loan had failed, the action of Gray in causing the loan to be paid was not a transfer "without fair consideration" within the meaning of Section 67d (2) of the Bankruptcy Act. Moreover, the Court finds that the Bank was deceived by the active misrepresentations of fact made by Gray and Twin City, therefore, would be liable delictually to make reimbursement to the Bank. The liability so resulting constitutes a "debt" as that term is broadly and specifically defined in the Bankruptcy Act and entitles the Bank to the protection afforded to a bona fide "obligee" under the statute. The numerous authorities sustaining a corporation's liability for fraud are collected in 19 *Corpus Juris Secundum*, Section 1278. The Bankruptcy Act recognizes that satisfaction of an

"antecedent debt" is one meaning of the term giving a "fair" consideration for the property. The circumstances of this case are unusual and the Court, viewing the matter in its entirety, considers that this is, in fact and in law, a situation in which the Court is called upon to exercise the traditional equity powers of a Court of Bankruptcy. The Court recognizes that noramally a transfer made to benefit a third party is not made for a "fair" consideration.

6.

This is not the normal case in which diversion of corporate assets for the payment of the indebtedness of another calls for application of the rule that such a transfer is not supported by a "fair consideration". Authorities cited by plaintiffs, including *Davis v. The Hudson Trust Company*, 28 F. 2d 740 (1928), and related cases are thus not in point. In none of the cases cited by plaintiffs was it established that the item sought to be recovered by the trustee in bankruptcy consisted of funds originally supplied by the defendant transferee from whom recovery was sought. The distinguishing factor making inapplicable the authorities relied upon by plaintiffs is that equity and legally Twin City here was obligated to make reimbursement to the Bank. The satisfaction of that obligation was satisfaction of an antecedent indebtedness within the meaning of the applicable provisions of the Bankruptcy Act, both in the definition of voidable transfers and in the protections afforded a bona fide obligee by the applicable provisions of the Chandler Act.

7.

The provisions of Section 67d (2) (d) invalidating transfers made with "actual intent" to "hinder, delay, or defraud either existing or future creditors" are, in view of the Court, not applicable to the repayment of this

$50,000.00 to the Bank under the circumstances that were present. There is no clear and convincing proof that in making the repayment Gray made it with actual intent to defraud the future creditors of Twin City Construction Company. Gray's fraud rather consisted in obtaining the bond by false representations. Once he had laid the basis for obtaining the bond, there is reason to believe that he did not consider that the repayment of the $50,000.00 to the Bank would affect his ability to carry out his contract at Blytheville, Arkansas, at a profit. He was utilizing the Gray organization and its central overhead and, to some extent, its credit position and it is more logical to conclude that he did not have the conscious and deliberate intent to defraud required by Section 67d (2) (d). The transfer was in payment of Gray's note to the Bank, but, as pointed out above, the transfer also satisfied an indebtedness of Twin City to the Bank. The circumstances all combine to support the inference that Gray was motivated by a desire to continue his business and to rehabilitate himself financially. The Court accepts Petty's testimony that Gray actually intended to pay his creditors, because he had worked out of bad situations before. The Court finds, therefore, that the repayment was not with actual intent to defraud. However, even if it be considered as part of an entire fraudulent transaction, the Court is of the opinion that the transfer is protected by Section 67 (d) (6) which protects an obligee who, without actual fraudulent intent, accepts a transfer based upon an antecedent debt. The Bank was in good faith in accepting the payment. The Court concludes that the Bank, under the circumstances, is a "bona fide" obligee within the proviso and protection of Section 67 (d) (6). Collier, *Bankruptcy Manual*, p. 858, states:

> "This proviso comes into play only after it has been determined that there has been a fraudulent con-

> veyance and that the transferee is not *bona fide* purchaser, lienor or obligee for a *present* fair equivalent value. Notwithstanding the absence of 'good faith' or 'a present' fair equivalent value, the transferee obtains protection to the extent of the consideration given by him if he can demonstrate his innocence of any intent to participate in the fraud perpetrated on the transferor's creditors. The new proviso seems to protect a transferee who without actual fraudulent intent has extinguished or accepted security for a debt owing by the bankrupt. If the antecedent debt amounts to a fair equivalent of the property transferred therefor, the transfer will presumably be upheld in full, although the transferee is technically not a 'bona-fide purchaser, lienor, or obligee for a *present* fair equivalent value'." (Emphasis supplied.)

As a *bona fide* obligee of Twin City, the Bank, the Court concludes, is entitled to retain the payment of funds representated by a reversal of the bookkeeping transfer when the check was issued to the Bank.

In the last analysis under the facts at issue, all that the Bank did was to receive reimbursement of a loan which it had made in good faith based on representations which did not reflect the true purpose in making the loan. The money was repaid within twelve days and never left the bank account. The Court does not believe the Chandler Act literally requires the Bank to repay the trustees under these circumstances. The harsh result contended for by the trustees is not within the intendment or purpose of the Statute. Recovery for the $50,125.00 item will, accordingly, be denied.

8.

The Court does not consider the cases cited by petitioners in their brief support any right of recovery by the trustees under the circumstances here found. There does not seem to be direct judicial authority in which a recovery under the exact circumstances here involved was sought by a trustee in bankruptcy under Section 67d. Implications from cases to which analogy might be made would deny any right of recovery as applied to the facts before the Court and the Court deems this to be the correct conclusion applicable to the circumstances at bar. See *Malone v. Gimpel*, 151 F. Supp. 549 (N.D.Y. 1956), affirmed by the C. C. A. 2nd Circuit (1957), 244 F. 2d 954; *Newfield v. Stieglitz, et al*, 47 F. Supp. 885 (1942), affirmed 137 F. 2d 437; *Cf. In Re Venie*, 80 F. Supp. 250 (1948).

The Court understands that counsel for the trustees have abandoned their contentions seeking recovery on the ground that the $50,000.00 repayment was *ultra vires*. Accordingly, the legal issues involved as to that aspect of the case will not be commented upon other than to say that they have been carefully considered by the Court and are found not to detract from the conclusions reached by the Court under the applicable bankruptcy statutes. The Court does not consider that the Uniform Fiduciaries Act, La. R.S. 9:3808, is here applicable in view of the full authority vested in Gray by the resolutions on file with the Bank and in further view of the fact that the repaid item of $50,000.00 was the same money which the Bank had placed in the account of Twin City at Gray's request when he made the loan.

II. THE $9,000.00 TRANSFER TO THE WILLIAM A. GRAY ACCOUNT.

FINDINGS OF FACT

1.

On December 28, 1955, within four months of the filing of the involuntary bankruptcy petition against Twin City Construction Company, Gray instructed the Pioneer Bank to transfer the sum of $9,000.00 from the checking account of Twin City Construction Company, maintained with the Bank, to the bank account of William A. Gray. A loan in the amount of $10,000.00 had been made by the Bank the same day and deposited to the account of Twin City Construction Company. The transfer was made by debit memorandum as per instructions. In issuing such instructions, Gray acted as President of Twin City Construction and acted pursuant to his full authority as evidenced by corporate resolutions furnished to and on file with the Bank (Exhibits D-2 & D-3). The Bank in good faith relied upon the authority vested in Gray in making the transfer pursuant to his request.

2.

The $9,000.00 so transferred inured to the benefit of W. A. Gray Construction Company in that it was used to cover disbursements made and charged to the checking account of W. A. Gray Construction Company. At the time of the transfer there was an overdraft in the account of W. A. Gray in the amount of $4,398.69 which had occurred in the normal course of business of W. A. Gray Construction Company. The balance, in the main, cleared disbursements made by W. A. Gray Construction Company to third parties.

3.

Overdrafts were not unusual in the normal conduct of the business of W. A. Gray Construction Company and deposits to cover overdrafts were frequently and normally made in connection with the handling of the checking account of W. A. Gray. The record establishes that such overdrafts occurred almost daily and it was the normal practice to cover such overdrafts by deposits in the W. A. Gray Construction Company account.

4.

The Bank did not, in fact, receive the $9,000.00 deposited in the checking account of W. A. Gray Construction Company but such funds were credited to the checking account of W. A. Gray Construction Company and were utilized to balance the account, including the payment of overdrafts.

5.

The Court finds as a fact that there was a considerable degree of commingling of the affairs of W. A. Gray Construction Company and Twin City Construction Company. The same office was occupied, the same personnel and central overhead staff was employed, and Gray, in practice, was using the W. A. Gray Construction Company in connection with the Twin City Blytheville contract being carried out.

6.

In the handling of the account of W. A. Gray Construction Company, including the crediting of the $9,000.00 to that checking account, the Bank had no reasonable cause to believe that either Gray or Twin City Construction Company was insolvent on December 29, 1955, when the debit memorandum transfer was effected. The insolvency of Twin City Construction Company as of that

date is not conclusively shown. In accepting the deposit of $9,000.00, in giving the credit, and by paying the items subsequently paid and covering the previously paid items included in the overdraft, the Bank acted in good faith and furnished a fair consideration in the form of such payments and bank clearances. In keeping with the practice in such matters the withdrawal of Gray was later entered as a receivable from Gray but it is clear that Gray was insolvent at the time. The Bank did not have reasonable cause to believe that Gray was insolvent on December 29, 1955.

CONCLUSIONS OF LAW

1.

The Trustees in Bankruptcy attacked the transfer of $9,000.00 above referred to under Section 67d (2) and also as voidable under State law by virtue of the provisions of 70e (1).

2.

Without dispute, W. A. Gray had authority to make the transfer of the $9,000.00 pursuant to resolutions on file with the Bank and the Bank, as a matter of law, was entitled to rely upon that authority, including the provision in the corporate resolution of authority which provides as follows:

> "BE IT FURTHER RESOLVED, That W. A. Gray, President, be and he is hereby empowered and authorized to do any and all acts whatsoever on such terms and conditions and for such considerations, within his discretion, that this corporation could do if a natural person, this authority conferred being intended to authorize the said W. A. Gray as President to represent this corporation

in all matters whatsoever and to confer on him the fullest possible powers in such representation."

3.

Under Section 67d (2) of the Bankruptcy Act, if the Bank had furnished "a fair consideration" for the transfer of the $9,000.00 by debit memorandum, the transaction is excepted from the reach of Section 67d (2) and is not voidable in and action brought by the trustees. Interpreting and applying Section 67d (2) to the facts, the Court concludes that the crediting of the account of W. A. Gray Construction Company with the $9,000.00 and the clearance of items against that credit, including clearance of the $4398.00 overdraft which had occurred in the normal and regular course of business, was the furnishing of a "fair consideration". Whether fair consideration is present in a particular case depends on all the facts and circumstances. See 4 Collier on Bankruptcy, Sec. 67.33, pp. 345-350. Because of the commingling of the affairs of Twin City Construction Company with those of W. A. Gray Construction Company and because of Gray's status as sole stockholder with full corporate authority (D-3) upon which the Bank actually relied, the Bank could not; in its dealings with him, have disregarded that authority especially where it had positive knowledge that the funds being transferred were in fact being used to cover clearances against the bank account representing, in the main, items payable by W. A. Gray Construction Company in connection with its construction business. By accepting the deposit, by giving the credit, and by paying the items already overdrawn, in good faith, the Court concludes as a matter of law that the Bank was furnishing a fair consideration for the deposit so received.

4.

The Uniform Fiduciaries Act adopted in Louisiana as La. R.S. 9:3801 *et seq.* does not entitle the trustees to recover under Section 70e (1) of the Bankruptcy Act. The purpose of the Uniform Fiduciaries Act is to protect a depository bank which acts in good faith without positive knowledge that a breach of trust is being committed. The act even recognizes the right of a fiduciary to transfer the funds from a fiduciary account to his personal account, Louisiana R.S. 9:3809. The Pioneer Bank & Trust Company was not required to make inquiry as to whether the fiduciary (W. A. Gray) was committing a breach of his obligation in transferring funds from the bank account of Twin City to that of W. A. Gray Construction Company. Especially is the Uniform Fiduciaries Act here applicable to protect the defendant Bank because the record establishes that it was making loans in good faith to both Gray and the corporation to finance construction contracts being carried out by Gray and Twin City and in practical effect Gray was Twin City.

5.

In the relationship between Bank and depositor, the Courts, in applying Section 60b of the Bankruptcy Act have looked with favor upon the position of the depositary bank and have protected the bank even when an insolvent depositor makes deposits in the course of business to cover an overdraft. Although the circumstances involved in this $9,000.00 transaction do no involve a voidable preference, the Court concludes that what occurred, under all of the facts and circumstances, cannot be viewed as a voidable transfer to the Bank within the meaning of Section 67d (2).

6.

Interpreting and applying 67d (2) (b) and (c) to the facts of this case, an important fact preventing recovery by the Trustees in Bankruptcy for this item is that this $9,000.00 was not transferred to the Pioneer Bank. The money was transferred to the checking account of W. A. Gray Construction Company and in fact inured to the benefit of W. A. Gray. The Bank was merely a depositary conduit through which the money passed. In this connection, the Court observes that in Civil Action No. 5445, on the Docket of this Court, the complainants, as Trustees of W. A. Gray Construction Company are seeking recovery of the same $4,398.69 overdraft on the theory that it was money belonging to Gray improperly paid to the Bank as a preference. Applying the law to the facts, we reach the conclusion that the $9,000.00 so transferred was transferred to W. A. Gray Construction Company and not to the Bank and we find no facts and circumstances to justify a recovery of any portion of the $9,000.00 item predicated upon any of the provisions of Section 67d (2) of the Bankruptcy Act.

The trustees have cited Articles 1970, 1971, 1980, 1984 and 1985 of the Civil Code of Louisiana and the decision of this Court in *Mayo v. Petty*, 153 F. Supp. 501 (1957) in favor of the Trustees in Bankruptcy, setting aside a deed as a voidable preference and a constructive fraud. The Court has considered these provisions of law and finds that they are not applicable to the facts here. Their application in *Mayo vs. Petty* was to circumstances quite distinguishable from the facts before us, as will appear from that decision.

III. THE $10,000.00 PLEDGE-AGREEMENT REPAID LOAN OF TWIN CITY CONSTRUCTION COMPANY

FINDINGS OF FACT

1.

On December 29, 1955, Twin City Construction Company borrowed $10,000.00 from the Pioneer Bank & Trust Company. Simultaneously with the loan, the Bank took a pledge agreement in keeping with its usual practice in making loans to finance construction contracts of W. A. Gray (Exhibit D-10). The written pledge agreement given by Twin City to the Bank, under date of December 29, 1955, specifically recites: "We pledge the balance due on this contract to secure a loan in the amount of $10,000.00 for a period of thirty (30) days." (See last paragraph of Exhibit D-10). The contract referred to, covered by the pledge, was the government contract for the rehabilitation of buildings at the Blytheville, Arkansas, Air Force Base.

2.

The loan was made to Twin City Construction Company within the four months period prior to the filing of the involuntary bankruptcy petition against Twin City Construction Company. Twelve days after the loan was made, the proceeds thereof were made available to Twin City Construction Company, the loan was repaid in full on January 10, 1956, by debit memorandum against the account of Twin City Construction Company in the amount of $10,020.00 (Exhibit D-14).

3.

The Court finds as a fact that the payment of January 10, 1956, was made by Twin City in full recog-

nition and confirmation of the validity of the pledge agreement of December 29, 1955, the payment having come directly from the proceeds of a check of the United States Government in the amount of $11,693.18 (Exhibit D-13), which was deposited to the account of Twin City Construction Company (see Exhibit D-12). The Court further finds as a fact that the $10,020.00 payment of the note was made on the same date and in connection with the deposit of the proceeds of the government contract as referred to and the Bank thereupon marked the note paid and returned it to Twin City Construction Company.

4.

The Court further finds as a fact that the debit memorandum of $10,020.00 was merely the means whereby Twin City Construction Company elected to carry out its obligation of recognizing and ratifying the pledge agreement under which the collected proceeds were required to be made available to the Bank in settlement of the loan that had been made only twelve days earlier.

5.

Notice of the letter pledge agreement above referred to was not given to the United States Government; but thereafter, within a period of twenty-one days from the date of the loan, to-wit, on January 10, 1956, twelve days after the loan, the proceeds of the government contract were paid to Twin City Construction Company and utilized by it to the extent of the $10,020.00 which retired the note.

CONCLUSIONS OF LAW

1.

The Trustees in Bankruptcy seek recovery of the $10,020.00 payment as a voidable preference under Section

60b of the Bankruptcy Act. The position of the Bank is: (1) that the letter pledge agreement of December 29, 1955, (Exhibit D-10), created a valid pledge so that the payment to the Bank, a secured creditor, was not preferential; (2) it is further contended by the Bank that even if the pledge did not create a valid pledge initially for lack of notice to the Government, the pledge was thereafter perfected by actual receipt of the money within twenty-one days from the date of the loan and act of pledge; (3) that non-compliance with the Federal Assignment of Claims Act does not affect the Bank's right. These contentions are all disputed by the trustees.

2.

Under the provisions of Section 60(a) (7) of the Bankruptcy Act, if it be conceded *arguendo* that the letter pledge agreement required additional action by the Bank to protect its security interest under the written pledge, it nevertheless clearly appears that the repayment of the money to the Bank (i.e., reducing the pledge fund to possession) had the legal effect of protecting and perfecting the lien of the pledgee and if this was accomplished within twenty-one days of the original loan, the transaction is protected by the Bankruptcy Act. Section 60 (a) (7) provides:

> "(7) Any provisions of this subsection a to the contrary notwithstanding, if the applicable law requires a transfer of property other than real property for or on account of a new or contemporaneous consideration to be perfected by recording, delivery or otherwise, in order that no lien described in paragraph (2) of this subsection could become superior to the rights of the tranferee therein . . . the time of transfer shall be determined by the following rules:

"1. Where (A) the applicable law specifies a stated period of time of not more than twenty-one days after the transfer within which recording, delivery or some other act is required, and compliance therewith is had within such stated period of time; or where (B) *the applicable law specifies no such stated period of time* or where such stated period of time is more than twenty-one days, and compliance therewith is had within twenty-one days after the transfer, the transfer shall be deemed to be made or suffered at the time of the transfer . . ." (Emphasis supplied).

It is plain that under Section 1 (30) (11 U.S.C.A., 1, as amended) of the Bankruptcy Act the term "transfer" includes the fixing of a lien or the perfection of a security interest. That section of the statute reads:

"(30) *'Transfer' shall include* the sale and every other and different mod direct or indirect, or disposing of or of parting with property or with an interest therein or with the possession thereof or of *fixing a lien upon property or upon an interest therein*, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, *pledge*, mortgage, *lien*, encumbrance, gift, security or otherwise; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor; . . ." (Emphasis supplied.)

Section 60 (a) (7) of the Bankruptcy Act was amended in 1950 to clarify and change the rule of law announced by the Supreme Court in the *Klauder* case, 318 U.S. 434, 63 S. Ct. 679, 87 L. Ed. 884. (See Collier, *Manual of Bankruptcy Law*, 1951 Supplement Section 60. 121, discussing the *Klauder* case and the effect of

the 1950 amendment.) Prior to the 1950 amendment if the Bank had made a loan to Twin City Construction Company within the four months period and taken a pledge agreement covering the contract proceeds, but it failed to notify the debtor of the credit (assuming Louisiana requires such notification), the Bankruptcy Act recognized the pledgee's lien as perfected only when the security interest was perfected by the required notice (or by the delivery to the pledgee of the thing pledged or by the payment of the money). The 1950 amendment had for its purpose the protection of those transactions which were inchoate, but were perfected within twenty-one days. It is the Court's conclusion that Louisiana law specifies no period of time in which the pledge of proceeds of a contract must be perfected by notice to the obligor. Consequently, under the literal provisions of 60a (7), the Bank, in making the loan to Twin City, in harmony with the Bankruptcy Act, could have perfected its lien under State law by notice to the debtor or by obtaining the proceeds within twenty-one days, the latter being not only a perfection, but a satisfaction of the lien. Cf. La. Civil Code Articles 3156, 3157, 3152 and 3153. It is our conclusion, in applying 60a (7) to the facts here found, that this is not a voidable preference, as a matter of law, because in receiving the payment the Bank was only doing what the Bankruptcy Act expressly permits and what State law sanctions. A more complete discussion of this subject and the relationship of this problem to the *Klauder* case and its background is found in Collier's *Bankruptcy Manual* (1951 Supplement), paragraphs 60-121 *et seq.* We conclude that the facts call for the application of Section 60a (7) and that the protection of that provision is directly applicable and available to defendant here. Even if it be conceded, as counsel for the trustees have argued, that the Bank's pledge was not complete for lack of notice to the obligor, the Government, its payment of the pro-

ceeds and Twin City's application thereof to the debt it had endeavored to secure, for a contemporaneous consideration — the loan — served to perfect the lien under a fair and reasonable interpretation of the Bankruptcy Act, in the light of the 1950 amendment.

3.

While the Court does not consider it necessary to base its conclusion denying recovery of the $10,000.00 item upon the validity of the original pledge, the Court nevertheless concludes on the basis of Louisiana R.S. 9: Section 4321-4323 that the letter pledge agreement executed in favor of defendant would of itself be sufficient to constitute a valid pledge without the necessity of notification to the debtor. That statute does not appear affirmatively to require the formality of notice to the debtor to make the pledge valid as to third persons. Only the obligor, whose obligation is intended to be pledged, is intended to be protected by the requirement of notice, "to bind the obligor to pay the amount due to the pledgee" (R.S. 9:4323). When this provision is considered in the light of the repealing clause, in Section 2 of Act 95 of 1938, it appears to the Court that the Louisiana Statute relied upon by defendant is sufficient to entitle the Bank to the status of a secured creditor under Louisiana law. It follows that the payment to the Bank was not preferential and voidable.

4.

In opposition to these conclusions of law it has been argued that there can be no valid assignment or pledge of a claim against the United States Government under a government contract without compliance with the provisions of Assignment of Claims Act, 31 U.S.C.A. § 203, and that any such attempted pledge is void. *National Bank v. Downie*, 1910, 218 U. S. 345. The Court finds

that the *Downie* case is not applicable and that this aspect of the argument of the trustees is disposed of adversely to their contentions by the case of *M. M. Landy, Inc., v. Nicholas*, 221 F. 2d 923 (CCA 5th, Fla.) where the Court held:

> "We conclude, then, that failure to comply with the Federal Assignment of Claims statute is immaterial in the decision of this case. By stipulation, Landy's security interest is not protected by the methods provided by this statute. Nevertheless, we recognize that there may be alternative ways of perfecting a security interest in a claim against the Government, under State law, which are valid as against a trustee or receiver in bankruptcy."

In our view, the pledge of the proceeds of a government contract is not voidable, although the provisions of the Federal Statute have not been complied with procedurally, if it appears that the proceeds of the claim pledged and assigned actually have been reduced to possession and no interest on the part of the Government is involved. In other words, that Statute is purely for protection of the Government. See *Martin v. National Surety Company* (1937) 300 U.S. 588, 81 L. Ed. 822, 57 S. Ct. 531, holding in effect, that assignments will be recognized as valid, even though not in conformity with the Federal Statute, if the proceeds have been collected and the matter is thus beyond the original purpose of affording protection to the Government. The conclusions which we reach, in our view, are amply supported by an extensive annotation found in 12 ALR 2d 468. To sum up, we conclude that the Assignment of Claims Statute is only for the protection of the Government and that as between the parties herein no government interest in involved. An assignment which is valid under local law will be recognized against the claim of a trustee in bankruptcy where a valid pledge exists under local law.

5.

Even should this Court conclude that the Bank is not a secured creditor, under Federal law applicable to set-offs it would be followed that the Bank would be protected on the $10,020.00 payment for it held the note of Twin City Construction Company and would have been entitled to offset the deposit against the note. See the following cases: *New York County Bank v. Massey*, 192 U.S. 138, 24 S. Ct. 199, 48 L. Ed. 380 (1904); *Studley v. Boylston Bank*, 229 U.S. 523, 33 S. Ct. 806, 57 L. Ed. 1313; *American Bank & Trust Co. v. Morris*, 16 F. 2d 845, (C.C.A. 5th, 1927); *Hill v. Jersey Shore State Bank*, (U.S.D.C. Pa. 1949) 87 F. Supp. 129; *Kane v. First National Bank of El Paso, Texas*, 56 F. 2d 534, 536, (C.C.A. 5th, 1932) certiorari denied 287 U. S. 603, 53 S. Ct. 8; *Citizens National Bank of Gastonia, N.C. v. Lineberger*, 45 F. 2d 522, (C.C.A. 4th, 930); *Fourth National Bank of Wichita v. Smith* (D.C. Kans., 1916) 240 F. 19; *Drugan v. Crabtree*, (C.C.A. Va. 1924) 299 F. 115. This Court recently applied this principle in the case of *Harper v. First National Bank of Mansfield*, Civil Action No. 5578. On the same subject matter, 3 *Collier on Bankruptcy* (15th Edition) pp. 760, *et seq.*, we find the following:

> "Obviously, where the bank has not knowledge or imputation of knowledge, or 'reasonable cause to believe, that the depositor is insolvent, such routine deposits are clearly available as setoffs. *But even though the deposior was insolvent and knowledge of this fact could be charged against the bank at the time when the deposit was made, the bank is still entitled to apply the deposit on its claim, so long as it was accepted in good faith, in the ordinary course of business.* It is only where affairs have reached such a point that the bank accepts the deposit for the purpose of payment or of giving itself a sub-

sequent advantage over other creditors through its right of set-off, or for some other special purpose, that the deposit and the subsequent application of it amounts to a recoverable preference." (Emphasis supplied).

6.

Summarizing our conclusions of law as to this claim, the Court finds that the requisites of a voidable preference, under Section 60b, are not present. It is the conclusion of the Court that the Bank had a valid security interest, that it perfected its lien by receiving payment within twenty-one days, and that the Federal Assignment of Claims Statute is no obstacle to recognition of the position of the Bank as a secured creditor. For these reasons, the Court concludes that there is no merit in the claim of the trustees for the recovery of this item.

For all of the foregoing reasons, plaintiffs are not entitled to recover from defendant on any of their claims.

A proper decree should be presented on notice.

THUS DONE AND SIGNED, in Chambers, at Shreveport, Louisiana, on this the 20th day of November 1958.

/s/ BEN C. DAWKINS, JR.
UNITED STATES DISTRICT JUDGE

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 17540

ROBERT K. MAYO, H. E. HARPER and JACK C. MURRELL, as Trustees in Bankruptcy of TWIN CITY CONSTRUCTION COMPANY, INC., Bankruptcy,

Appellants,

versus

PIONEER BANK & TRUST COMPANY,

Appellee.

Appeal from the United States District Court for the Western District of Louisiana.

(September 30, 1959.)

Before JONES, BROWN and WISDOM, Circuit Judges.

WISDOM, Circuit Judge. The Trustees in Bankruptcy of Twin City Construction Company, a Louisiana corporation, sued The Pioneer Bank and Trust Company of Shreveport, Louisiana, to recover $69,145. The Trustees contend that, under Sections 60(b) and 67(d) of the Bankruptcy Act, 11 USCA 96(b), the bankrupt corporation made certain voidable transfers to the bank. Three separate claims are involved: (1) one for $50,125; (2) one for $9,000; and (3) one for $10,200. The case was

tried to the court without a jury. The district judge rejected all three claims of the Trustees. We affirm as to the first two claims, reverse and remand as to the third claim.

I. Background

For many years William A. Gray of Shreveport engaged in the construction business under the name of W. A. Gray Construction Company. To all appearances he was a successful contractor. For several years, however, before he died in 1956, he was in bad financial straits. With considerable skill he managed to conceal his financial plight until January, 1956.

Pertinent to this action is the fact that Gray was the president and sole stockholder of Twin City Construction Company, a corporation Gray organized in 1951. Twin City conducted not business prior to the transactions in question in this case.

Gray had an established line of credit at the Pioneer Bank. When the bank was organized in 1945, Gray was one of its first depositors and customers. Over a long course of dealings, the bank made many loans to Gray to finance his construction business and to permit him to start and carry forward individual construction contracts. Pioneer Bank had never sustained a loss on any loans to Gray. Rupert Campbell, President of the Pioneer Bank, handled Gray's account himself. The district judge found: "It is apparent that those who did business with Gray had utmost confidence in his ability to meet his financial obligations."

March 12, 1956 an involuntary petition in bankrutcy was filed against Gray. Two weeks later, on his voluntary petition, he was adjudicated a bankrupt. April 13, 1956 an involuntary petition in bankruptcy was filed against Twin City Construction Company by the Home

Indemnity Company. April 21, 1956, Twin City voluntarily was adjudicated a bankrupt.

At the time of the trial, Twin City owed $71,045.32 in unsecured claims and $4,531.38 in taxes; the company had assets of $91.14. Gray owed $794,277.99 in unsecured claims and $5,435.82 in taxes; he had assets of $8,771.23.

II. The Claim for $50,125

On May 28, 1955, Gray talked with Campbell, about obtaining a loan of $50,000. He told Campbell that he wanted to give up doing business individually and do business in corporate form by activating Twin City Construction Company and channeling his construction contracts into that corporation. He stated that his health had been poor and that by using Twin City he could insure continuity and avoid personal liability. Gray said that he had arranged to obtain needed capital from a cousin who was going into business with him.

The Pioneer Bank made the loan of $50,000, taking Gray's personal note, payable in fifteen days. At Gray's direction, the money was deposited in Twin City's checking account. Shortly thereafter, Gray issued to himself stock of Twin City amounting to $49,500. At the time of the loan the bank held collateral mortgages amounting to $40,000 on Gray's office building and equipment, a $40,000 mortgage on his home, and a pledge of all the stock of the Blair Apartments which Gray owned. Gray gave the bank copies of corporate resolutions authorizing him "to enter into any and all contracts whatsoever for Twin City and to do any and all acts whatsoever on such terms and conditions and for such considerations, within his discretion", the intention being "to authorize W. A. Gray as President to represent this corporation in all matters whatsoever and to confer on him the fullest possible powers of representation." The resolutions also

authorized the Pioneer Bank "to honor, receive, certify or pay all instruments [sgned by Gray] . . . even though drawn or endorsed to [Gray] . . . or in payment of the individual obligation of such officer, or for deposit to his personal account, and said Bank shall not be required, or be under any obligation to inquire as to the circumstances of the issuance, or use of any [such] instrument . . ."

Twelve days later, June 9, 1956, Gray informed the Pioneer Bank that his plans had fallen through, that "the fellow who was going to put the money in with him wouldn't go", and that there was no necessity for the loan. The transaction was then closed out by payment to the bank of principal and interest, $50,125, in the form of a check drawn by Gray as president of Twin City. None of the $50,000 credit traceable to the loan had been withdrawn from Twin City's account. Thus, except for bookkeeping purposes to reflect a loan to Gray and deposit to the account of Twin City, the $50,000 did not leave the possession of the bank. Payment of the loan simply required a reversal of bookkeeping entries and in effect the indentical $50,000 originally credited to Twin City was returned to the bank.

In the interval between the loan and its repayment, Twin City had a certified audit prepared showing a credit balance of $50,000 in the Pioneer Bank. This audit report and a financial statement were used by Gray in obtaining for Twin City a contractor's performance bond from the Home Indemnity Company. Before issuing a bond, but after the $50,000 loan had been repaid, Home Indemnity Company conducted an investigation of Twin City's application for a bond. Home Indemnity's investigator obtained a routine verification from the bank that as of May 31, 1955 Twin City had a balance of $50,000 in the Pioneer Bank. The bonding company made no attempt

to inquire as to whether the $50,000 or any part of it was on deposit after May 31, 1955. On completion of its investigation and after it had satisfied itself with the personal guaranty of W. A. Gray, Home Indemnity wrote the bond June 21, 1956.

Twin City had only one construction contract, a government contract at Blytheville, Arkansas. Eventually the company defaulted and Home Indemnity, as the insurer, paid bills of $52,130.42 to complete the contract.

The district judge found that the Pioneer Bank had no knowledge of the issuance of Twin City stock to Gray and no knowledge of Gray's intention to have the stock issued to himself in return for the proceeds of the loan. The district judge found that the Bank's officers and employees were not parties to any misrepresentation of any character to the bonding company. The bank acted in good faith and was as much deceived by Gray as the bonding company was deceived. Just prior to the collapse of his operations in January of 1956, Gray had nine large government construction contracts in Arkansas. The district judge stated: "[T]he apparently substantial character of Gray's business and account with the bank justified the course of dealing and confidence the bank's president had in him." The record amply supports the findings of the district court.

This Trustees argue that the Twin City payment of $50,125 was a voidable transfer for three reasons. (A) Twin City's payment of Gray's personal debt to the Bank was a transfer "without fair consideration" under the constructive fraud provisions of Section 67d(2)(b), 11 USCA 107(2)(b). (B) The transfer was part of a scheme to hinder, delay, or defraud creditors within the meaning of Section 67d(2)(d), 11 USCA 107d(2)(b). (C) The payment is voidable pursuant to Section 70(e) of the Bankruptcy Act, under the Uniform Fiduciaries Act as

adopted in Louisiana, LSA-R.S. 9:3801-3814, particularly LSA-R.S. 9:3808.

A. *Payment to the bank was not a transfer by Twin City without "fair consideration" under the constructive fraud provisions of the Bankruptcy Act.* 11 USCA 107d (2) (b).[1]

The Trustees argue that on completion of the loan to Gray, the $50,000 was Gray's to use as he pleased. When he chose to spend it by buying stock in Twin City, the money then belonged to Twin City. Twin City was a third party transferee, as to the bank. According to the Trustees' argument when Twin City, the bankrupt, under no obligation to the bank, paid Gray's loan, it was the payment of a debt of another without "fair consideration", under the language of the Act, and therefore a voidable transfer.

There is no doubt that usually a diversion of corporate assets for the benefit of a third person, such as the payment of the loan of another, is a transfer without "fair consideration".[2] This however is not the usual case.

The trial court found that repayment to the bank of the identical bookkeeping credit reflecting the proceeds of a loan never withdrawn was supported by a fair equivalent in value. The district judge held that

1 11 USCA 107d(2)(b) provides: "Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition initiating a proceeding under this title by or against him is fraudulent . . . (b) as to then existing creditors and as to other persons who become creditors during the continuance of a business or transaction, if made or incurred without fair consideration by a debtor who is engaged or is about to engage in such business or transaction, for which the property remaining in his hands is an unreasonably small capital without regard to his actual intent."

2 "Transfers made to benefit third parties are clearly not made for a fair consideration'. IV Collier on Bankruptcy, (14 Ed.) p. 363. Davis v. Hudson Trust Co., 3 Cir., 1928, 28 F.2d 740, cert. den. 278 U.S. 655, 49 S.Ct. 179, 73 L.Ed. 565; Barr v. Zoller, 2 Cir., 1940, 109 F.2d 924; Irving Trust Co., Trustee v. B. Altman & Co., 1933, 270 N.Y.S. 781; Hansen v. Cramer, S.Ct. Cal., 1952, 245 P.2d 1059.

under the law of Louisiana, either on the principle of quasi-contract (unjust retention of a benefit)[3] or delictual responsibility,[4] the circumstances gave rise to an antecedent indebtedness of Twin City sufficient to satisfy the requirement of "fair consideration". The court found: "The circumstances of this case are unusual and the Court, viewing the matter in its entirety, considers that this is, in fact and law, a situation in which the Court is called upon to exercise traditional equity powers of a Court of Bankruptcy."

Whether fair consideration has been given for a transfer is "largely a question of fact, as to which considerable latitude must be allowed to the trier of the facts".[5] We find that the record supports the findings of the trier of the facts in this case.

We are of the opinion that it is unnecessary to decide whether the facts meet the Louisiana requirements for a quasi-contract or a tort. We hold, as to the claim for $50,125, that the facts justify disregarding the fiction that Twin City was a separate legal entity. Gray and Twin City were one.

There was such a degree of identity and commingling of affairs between Twin City and Gray that the corporation and its sole stockholder cannot be regarded as separate legal entities, insofar as the $50,000 loan is concerned. Gray was the sole stockholder. The corporate resolutions authorized Gray to act for Twin City in what-

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3 Louisiana Civil Code, Articles 1896, 2292, 2293, 2294, 2300, 2301. See also Howe, Studies in the Civil Law (N.O. 1896), Chap. X, 170-190.

4 "Every act whatever of man that causes damage to another, obliges him by whose fault it happened to repair it." La. Civ. Code, Art. 2315.

5 "Whether a fair consideration has been given for a transfer must depend on all the circumstances of the case. Fairness in every case is largely a question of fact, as to which considerable latitude must be allawed to the trier of the facts." Collier's Bankruptcy Manual (Oglebay, Kelliher and Newkirk) (1948), P. 845, discussing Section 67d.

ever way he saw fit, and authorized the Bank to honor Twin City checks drawn by Gray to pay personal debts. The loan was made on Gray's credit, but the proceeds inured immediately to Twin City's credit and the outstanding purpose of the loan as stated to the bank, was to enable Gray to do business as Twin City Construction Company instead of W. A. Gray Construction Company. The hidden purpose was to enable Gray to obtain a performance bond in the name of Twin City that Twin City was not entitled to on the state of its finances and that Gray could not obtain on the state of his finances. After this object was accomplished, and before Twin City could even begin a separate existence, Twin City, through Gray, paid back the identical money lent to Gray and deposited in the corporate account only twelve days before. From the beginning to the end of the transaction Gray, as Gray, or Gray, as Twin City, made no effort to separate himself from his corporation — so far as the bank is concerned. To the extent that Gray is separable from Twin City, the loan was for the benefit of Twin City; if the loan was for the benefit of Gray, the bank had no alternative, under the language of the resolutions, to honoring Gray's signature and instructions.

It is one thing to observe the corporate fiction as if the fiction were the truth — when the fiction is not abused. It is quite a different thing when the sole stockholder either ignores the corporation as a separate entity or uses the corporate fiction as an instrument of deceit. Here, the corporation and the individual owner were two sides of a single false coin.

Experienced counsel represent the parties to this appeal. They have not been able to find a case that this

Court regards as similar on the facts to the instant case.[6]

Section 67d(1)(e) provides that consideration is "fair when, in good faith, in exchange and as a fair equivalent therefor, property is transferred on an antecedent debt is satisfied". Section 67d(1) defines debt broadly as "any legal liability, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent."

The requirement of "fair consideration" is aimed at preventing a bankrupt depleting his estate just preceding his bankruptcy either by improvidence or by action intended to defeat creditors or favor friends. As we read the statute in the light of its purpose, we think that the voidable transfer provisions were never intended to apply to this case. Here, Gray-Twin City, having accomplished the object of the loan in obtaining a performance bond, repaid the loan. There was no improvidence as in making a transfer with grossly unfair consideration, and no constructive or actual intention to defeat creditors or favor friends.

It seems to us that of the things Gray did, the thing that he did in paying the loan was a far, far better thing than the record shows he had ever done.

B. *The transfer was not part of a scheme to hinder, delay, or defraud creditors within the meaning of Section 67d(2)(d), 11 USAC 107d(2)(d).*[7] As distinguished from

[6] Section 67d(2) on which the trustees rely is taken from Section 5 of the Uniform Fraudulent Conveyances Act (not adopted in Louisiana); see 9B Uniform Laws Annotated, p. 102. Maclachlan, Handbook of the Law of Bankruptcy (Hornbook Series, 1956), page 271, states: "There are surprisingly few cases under or corresponding to Section 5 of the Uniform Act. It has been cited several times merely as a make-weight in opinions finding actual fraud or insolvency or both."

[7] Subsection (d) provides a transfer is fraudulent "as to then existing and future creditors, if made or incurred with actual intent as distinguished from intent presumed in law, to hinder, delay, or defraud either existing or future creditors." 11 USCA 107d(2)(d).

107d(2)(b), subsection (d) requires a showing of "*actual intent*" to defraud creditors in order to set aside a transfer. Actual intent is a question of fact.[8] The district court held — and we agree — that there was no proof of actual intent to defraud creditors of Twin City. Gray's misrepresentations related to obtaining the bond. At the time the loan was repaid, Gray expected Twin City to be able to complete the Blytheville contract. He was confident that the venture would be a profitable one and that he would be able to rehabilitate himself financially. Although a transfer may have the effect of hindering or delaying or defrauding creditors, incidental effect is not enough to satisfy the requirement of actual intent to defraud. *Coder v. Arts*, ..., 213 U.S. 436, 29 S. Ct. 436, 53 L.Ed. 772; In Re Braus, 2 Cir., 1917, 248 F. 55. In any event, the Bank accepted the payment in good faith and is therefore a bona fide obligee within the protection of Section 67(d)(6).

C. *The Trustees' argument for relief under the Uniform Fiduciaries Act*, LSA-R.S. of 1950, 9:3801 et seq., must also fail. Section 3805[9] provides that a payee of a check or bill of excharge is liable to the drawer's prin-

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[8] "The approach under §67d-(2)(d) is to be purely factual." 4 Collier on Bankruptcy, § 67, page 369.

[9] "Payee of check or bill of exchange; duties and libility—If a check or other bill of exchange is drawn by a fiduciary as such or in the name of his principal by a fiduciary empowered to draw such instrument in the name of his principal, the payee is not bound to inquire whether the fiduciary is comiting a breach of his obligation as fiduciary in drawing or delivering the instrument and is not chargeable with notice that the fiduciary is committing a breach of his obligation as fiduciary unless he takes the instrument with actual knowledge of such breach or with knowledge of such facts that his action in taking the instrument amounts to bad faith. If, however, such instrument is payable to a personal creditor of the fiduciary and delivered to the creditor in payment of, or as security for a personal debt of the fiduciary, to the actual knowledge of the creditor, or is drawn and delivered in any transaction known by the payee to be for the personal benefit of the fiduciary, the creditor or other payee is liable to the principal if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the instrument." LRA-R.S, § 9:3805.

cipal for the proceeds if: (1) the payee had actual knowledge that the drawer-fiduciary committed a breach of trust, or (2) if, in drawing the instrument, the drawer has in fact committed a breach of trust unknown to the payee, but the payee did know that the drawer was paying a personal debt. Under Section 3808[10] a drawee-bank becomes liable to the principal when a fiduciary draws a check on the principal's account to pay a personal debt if in fact the fiduciary commits a breach of trust.

The important factor under the Act in holding a bank responsible for a fiduciary's breach of trust is whether or not the debt that was paid was for the *personal use* of the fiduciary. Thus, relief under the Act was allowed in *LaVechia v. North Carolina Joint Stock Land Bank*, N.C., 1940, 9 S.E.2d 489, where the debtor drew a check as president of the company to buy land for his personal use. No part of the loan or its use inured to the company. *Anacostia Bank v. United States Fidelity & Guaranty Co.*, D.C. Cir., 1941, 119 F.2d 455, involved a guardian-ward situation. The court implied that if the guardian had used the guardianship funds to pay a debt that in some way benefited the ward, instead of the guardian only, the drawee-bank would not be liable. But the loan was solely for the personal use of the guardian.

The loan to Gray, however, was not a loan to a corporate officer for his personal benefit such as the Act

10 "Check upon principal's account; liability of bank paying—If a check is drawn upon the account of his principal in a bank by a fiduciary who is empowered to draw checks upon his principal's account the bank is authorized to pay any such check without being liable to the principal, unless the bank pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in drawing such check, or with the knowledge of such facts that its action in paying the check amounts to bad faith. If, however, such a check is payable to the drawee bank and is delivered to it in payment of, or as security for, a personal debt of the fiduciary to it, the bank is liable to the principal, if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the check." LSA-R.S. § 9:3808.

contemplates. To the knowledge of the bank, the loan was for the benefit of Twin City and deposited to Twin City's account. The conditions necessary for relief under the Act are not present here: The debt incurred was not the kind of personal debt contemplated by the Act; the Bank did not have actual knowledge of any breach of trust as to Twin City, if one was committed at all.[11]

II. The $9,000 Claim

On December 28, 1955, within four months prior to the filing of the involuntary petition in bankruptcy against Twin City, the bank made a loan of $10,000 to Twin City. That same day Gray instructed the Bank to transfer $9,000 from Twin City's checking account to Gray's personal account. The transfer was accomplished by debit memorandum. Gray was acting as president of Twin City and pursuant to the extremely broad powers vested in him by the corporate resolution when he requested the transfer of funds.

The $9,000 inured to the benefit of W. A. Gray Construction Company in that it was used to cover disbursements made and charged to the checking account of W. A. Gray Construction Company. At the time of the transfer Gray's personal account was overdrawn in the amount of $4,398.69 which had occurred in the normal course of business of W. A. Gray Construction Company. Overdrafts occurred frequently in Gray's account. In

[11] The corporate resolutions provided, in part: "FURTHER RESOLVED, That Pioneer Bank & Trust Company be and it hereby is authorized to honor, receive, certify, or pay all instruments signed in accordance with the foregoing resolution even though drawn or indorsed to the order of any officer signing the same or tendered for cashing, or in payment of the individual obligation of such officer, or for deposit to his personal account, and said Bank shall not be required, or be under any obligation to inquire as to the circumstances of the issuance, or use of any instrument signed in accordance with the foregoing resolution, or the application, or disposition of such instrument, or the proceeds thereof;"

1955 overdrafts were almost a daily occurrence. It was normal practice to cover such overdrafts by deposits in the W. A. Gray Construction Company account.

The district court found that Pioneer Bank did not in fact receive the $9,000 deposited in the checking account of W. A. Gray Construction Company. The funds were credited to the checking account of the Construction company and were utilized to balance the account, including the payment of overdrafts.

The Pioneer Bank was financing Twin City on one contract and Gray on nine contracts. When the Bank received the transfer of $9,000 it had no reason to believe that either Twin City or Gray was insolvent. Certainly the bank would not have made a loan to Twin City on December 29, 1955, if it had any idea that Twin City was insolvent. The district court found that the Pioneer Bank acted in good faith in accepting the deposit of $9,000, in giving the credit, and by paying the items subsequently paid and covering the items included in the overdraft.

Under Section 9 of the Fiduciaries Act (LSA-R.S. 9:3809),[12] the bank is protected. This section reads:

> "If a fiduciary makes a deposit in a bank to his personal credit of checks drawn by him upon an account in his own name as fiduciary, or of checks drawn by him upon an account in the name of his principal if he is empowered to draw checks thereon, or of checks payable to his principal and endorsed by him, if he is empowered to endorse such checks, or if he otherwise makes a deposit of funds held by him as a fiduciary, the bank receiving such

[12] This portion of the Trustees' claim, and the portion of the claim under the $50,125.00 item that is based on state law is allowed by the Bankruptcy Act, 11 USCA 110 (e) (1), which allows recovery if a transfer or obligation violates state or federal law.

deposit is not bound to inquire whether the fiduciary is committing thereby a breach of his obligation as fiduciary; and the bank is authorized to pay the amount of the deposit or any part thereof upon the personal check of the fiduciary without being liable to the principal, unless the bank receives the deposit or pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in making such deposit or in drawing such check, or with knowledge of such facts that its action in receiving the deposit amounts to bad faith."

The purpose of Section 3809 is to protect a depository bank that acts in good faith without any knowledge other than the fact that funds are being transferred by a fiduciary to his personal account or to persons with whom he is dealing. Such knowledge alone will not satisfy the requirement of actual bad faith or knowledge that the fiduciary committed a breach of trust.

The record is devoid of any evidence showing actual knowledge of a breach of fiduciary duty. And, the previous course of dealings between the parties, the identity of Gray with Twin City, and the broad powers authorizing Gray to act for Twin City (if the corporate fiction is entitled to weight in the circumstances of this case) support the view that the bank acted in good faith.

The trustees contend that they are at least entitled to recover the amount of the overdraft. They argue that receiving fiduciary funds in payment of a fiduciary's overdraft is not covered specifically by the Uniform Fiduciaries Act and that, under ordinary rules of liability which apply in situations not covered by the Act, the bank is liable.

LSA-R.S. 9:3912.[13] The trustees point out that the Act has for its purpose the protection of commercial transactions in which credits and bills of exchange are involved, not a transfer of funds in payment of a personal debt by means of a debit memorandum or a deposit in a fiduciary account which has the mechanical effect of paying the debt. The trustees rely on *Colby v. Riggs*, D.C. Cir., 1937, 92 F.2d 183. In that case a fiduciary who had overdrawn his personal account drew a check upon the fiduciary account payable to himself individually and deposited it in the bank to the credit of his personal account. The Court held that the Act did not protect the bank since the bank did not receive the check in payment of the depositor's personal indebtedness to it. Two of the five judges in Colby wrote dissenting opinions. We feel that the dissent expresses the better view.[14] The line between giving a check to a bank to pay a personal debt and depositing a check in an overdrawn account is too fine a line for us to discern. The effect of Colby would be "to make the application of the Act to the innocent transferee, whom it seeks to protect, depend upon the banking procedure employed by this defalcating trustee seems unnecessarily formalistic". Comment, 51 Harv. L. Rev. 563 (1937).

III. The $10,020 Claim

Twin City borrowed $10,020 from the Bank on December 29, 1955. At the same time the bank took a pledge agreement in keeping with its usual practice in making loans to finance Gray's construction contracts.

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[13] "Cases not provided for; rules applicable—In any case not provided for in this Chapter the rules of law and equity, including the law merchant and those rules of law and equity relating to trusts, agency, negotiable instruments and banking, shall continue to apply." LSA-R.S. § 9:3812.

[14] Scott and Paton criticize Colby. III Scott on Trusts (2d Ed. 1956, Sec. 324.5, p. 2345; II Paton's Digest (1942) p. 1759. The case is noted in 38 Cal. L. Rev. 495; 23 Cornell L.Q. 483; 51 Harv. L. Rev. 563; 47 Yale L.J. 994; Mich. L.Rev. 160.

Twin City pledged the balance due on Blytheville contract it had with the federal government to secure the loan. No notice of the pledge was given to the government. Twelve days later the government made a payment of $11,693.18 to Twin City on the contract. The proceeds were deposited in Twin City's account. Twelve days after the loan was made, Twin City directed the bank to enter a debit memorandum against the account for $10,020 to repay the loan. The transaction took place within the four month period prior to the filing of the involuntary petition in bankruptcy against the company.

The Trustees contend that payment of the loan was a voidable preference under the Bankruptcy Act, 11 USCA 96(a) and (b). Their argument is three-pronged: (A) the pledge was invalid because notice was not given to the government as required by the Federal Assignment of Claims Act, 31 USCA 203; (B) the pledge was invalid under state law because of lack of notice; (C) the bank had no right of set-off. The district court held that notice was not necessary to perfect the pledge because payment within twelve days perfected it. The court also held that the Bank had a right of set off. We reverse and remand.

A. The district court held that failure to comply with the Federal Assignment of Claims Act was not fatal to the validity of the pledge. We do not question that portion of the opinion. Where it appears that the government has paid or honored a claim, or no longer has any vital interest, the assignment is good between the parties or their successors in interest in spite of the fact that the government was not given notice of the assignment. *Martin v. National Surety Co.*, 1936, 300 U.S. 588, 57 S.Ct. 531, 81 L.Ed. 822; Matter of Ideal Mercantile Corporation, 2 Cir., 1957, 244 F. 2d 828; *M.M. Landy, Inc. v. Nichols*, 5 Cir., 1955, 221 F.2d 923, 53 ALR 2d 1385;

in Re Webber Motor Co., D.C. N.J., 1943, 52 S.Supp. 842. Payment by the government to Twin City removed the case from the scope of rule expressed in *National Bank of Commerce v. Downie*, 1910, 218 U.S. 345, 31 S.Ct. 89, 54 L.Ed. 1065, and brought it within the narrower limits of the Martin case.[15]

We cannot, however, agree with the district court's construction of the Louisiana law of pledge and the bankruptcy principles applicable to set off.

In order to have a preference under the Bankruptcy Act, six statutory elements must exist: (1) there must be a transfer of the debtor's property, (2) to or for the benefit of a creditor, (3) for or on account of an antecedent debt; (4) the transfer must be made or suffered while the debtor is insolvent, (5) within four months of bankruptcy; and (6) the effect of the transfer must be to enable the creditor to obtain a greater percentage of his debt than another creditor of the same class. See 3 Collier on Bankruptcy § 60, page 753. If any of the six vital elements is lacking, there is no preference under Section 96(a). But when the requirements of 96(a) are met, the preference will be voidable only if, under Section 96(b), the transferee had reasonable cause to believe that the debtor was insolvent at the time of the transfer.[16]

Prior to the 1950 amendment to Section 96(a), an assignment of a claim without notice as required by

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[15] The cases are collected in 12 ALR 2d 460. See also Note Assignment of Government Contracts as Collateral, 101 Pa. L. Rev. 106 ( ).

[16] "On the other hand, where a preference as defined in §60a [11 USCA 96 (a)] is found to exist, there can, nevertheless, be no avoidance of such a perference under § 60b [11 USCA 96 (b)] unless the transferee had reasonable cause to believe that the debtor was insolvent. In all such cases, the burden of proving the existence of these essential elements is upon the trustee seeking to avoid the transfer." 3Collier in Bankruptcy § 60, p. 757.

state law to the debtor of the claim could be struck down even though the assignment was made prior to the four month period. The theory was that if the lien was never perfected according to state law, or if it was perfected some time after the transfer (assignment), it was deemed to have been made within the four month period. Also, if perfection and execution were not simultaneous the assignment was for an antecedent debt because the date of perfection controlled. See *Corn Exchange National Bank & Trust Co. v. Klauder*, 1943, 318 U.S. 434, 63 S.Ct. 679, 87 L.Ed. 884. In 1950 Section 96(a) was amended in order to dilute the harshness of the Klauder rule. Thus, House Report No. 1293, August 22, 1949, 81st Cong. 1st Sess., states that the purpose of the amendment was to provide "that no transfer made in good faith, for a present new consideration, shall constitute a preference to the extent of such consideration actually advanced, *if the provisions of applicable State law governing such transfers are complied with, with an appropriately rigid time limitation (21 days) for such perfection if such limitation is not itself prescribed by the applicable State law.*" As the Section stands today, if a lien, which is a transfer for purposes of the Act, is perfected under state law within twenty one days, or a shorter period if specified by state law, then the transfer is treated as if it were made when executed even though execution and perfection were not simultaneous. 11 USCA 96(a)(7). If it is treated in this manner there is no transfer for an antecedent debt, a vital element in establishing a preference.[17]

B. Therefore, the issue presented here narrows down to whether the pledge was validly perfected under

[17] The general rule is that a transfer is made when **perfected**. 11 USCA 96 (a). Thus, but for 96 (a) (7), all transfers that were not perfected when **executed** would be transfers for an antecedent debt.

Louisiana law within twenty one days[18] as required by 96(a)(7). The district court held that payment within twelve days perfected the pledge. Thus, the court implied, the transfer was for a new and present consideration, and the antecedent debt element of preference was lacking.[19] We are compelled to disagree with this view of Louisiana law.

Payment did not perfect the pledge. The only way a pledge of a credit evidenced by a non-negotiable instrument can be perfected in Louisiana is by delivery of the instrument to the pledgee and by written notice to the debtor on the instrument. Articles 3158, 3160, Louisiana Civil Code of 1870; *Commercial Bank of Alexandria v. Shanks*, 1911, 129 La. 861, 56 So. 1028. See also Slovenko, Of Pledge, 33 Tul. L.Rev. 59, 106-107 (1959). It is the notice to the debtor of the credit that amounts to constructive possession of the credit. Denis, Contract, of Pledge (N.O. 1898), p. 29,479. Article 3160 of the Code provides:

> "When a thing given in pledge consists of a credit or instrument not negotiable, the pledge shall be complete as to all the world, as soon as the debtor of such pledged credit or instrument shall have been notified in writing of the giving of such pledge."

Lack of notice will not affect the validity of the pledge as between the parties. *Sambola v. Fandison*, La. App., 1938, 178 So. 276. But under Section 70(e)(1) of the Bankruptcy Act, 11 USCA 110(e)(1), the Trustee stands in the shoes of a general creditor who could attack the pledge. The Trustees' argument that LSA-R.S. of 1950, 9:4321-4323 changed the notice requirement in Louisiana

[18] Louisiana law does not require a specific time limit for perfecting a pledge. See Articles 3158, 3160, La. Civ. Code of 1870.

[19] A transfer for a new and present consideration, even one within the four month period, can never be attacked as a preference. Wolf v. Aero Factors Corp., 2 Cir., 1955, 221 F.2d 291.

is without merit. Those sections relate only to obligations not evidenced by a written instrument.

Since the pledge was not validly perfected under Louisiana law, the district court must inquire into the other elements of a preference to see if one existed and whether it was voidable under Section 96(b).

C. We must also reverse on the issue of set off.[20] Generally, a bank may apply the debtor's deposits on his debts to the bank as they mature. 5A Michie, Banks and Banking, § 114. In the absence of fraud or collusion, or an intent to effect a preference, a debtor's insolvency will not affect the bank's right of set off if the deposit was made in the ordinary course of business and the money deposited was subject to withdrawal by the depositor. *First National Bank v. Fox*, 6 Cir., 1940, 111 F.2d 810. "It is well-settled", the court said in the Fox case, "that in the absence of fraud and collusion or intent to effect a performance, a bank may set off a deposit made in the ordinary course of business, and subject to withdrawal by the depositor even though it may know the depositor is insolvent at the time". However, a set off may be attacked as a voidable preference under certain circumstances.

In *Cusick v. Second National Bank*, D.C. Cir., 1940, 115 F.2d 150, in which the bank set off a debtor's deposits

20 The bank's right of set-off in relation to bankruptcy problems is governed by 11 USCA 108 which provides: "Set-offs and counterclaims—a. In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set-off against the other, and the balance only shall be allowed or paid. b. A set-off or counterclaim shall not be allowed in favor of any debtor of the bankrupt which (1) is not provable against the estate and allowable under subdivision g of section 93 of this title; or (2) was purchased by or transferred to him after the filing of the petition or within four months before such filing, with a view to such use and with knowledge or notice that such bankrupt was insolvent or had committed an act of bankruptcy. July 1, 1898, 541, § 68, 30 Stat. 565; June 22, 1938, c. 575, § 1, 52 Stat. 872."

of funds that were paid pursuant to two construction contracts against two loans made by the bank, the court said that the trustees could attack the set off as a voidable preference if: (1) at the time of the deposits either the company or the bank intended them to operate as payment of the debt rather than as an ordinary deposit subject to the depositor's withdrawal; (2) at the time of the deposit the depositor was in fact insolvent; and (3) the bank had reasonable cause to believe the depositor was insolvent at that time. Under the facts surrounding the Twin City deposit we think the deposit was for the purpose of payment of the debt. As soon as Gray received the proceeds under the contract he transferred them by debit memorandum to the Bank. The deposit was made solely to repay the loan. It was a cloak for payment. See *Citizens' National Bank v. Lineburger*, 4 Cir., 1930, 45 F.2d 522.

Thus, there was a transfer that might constitute a voidable preference.[21] Accordingly we must reverse and remand the case for the district court to make additional findings on the Trustees' third claim, for $10,020.

The judgment is AFFIRMED in part and REVERSE and REMANDED in part.

[21] Ordinarily a deposit in a bank is not a transfer under Section 96(a) and cannot be a preference. Studley v. Boylston National Bank, 1913, 229 U.S. 523, 33 S.Ct. 806, 57 L.Ed. 1313; New York County Bank v. Massey, 1904, 192 U.S. 138, 24 S.Ct. 199, 48 L.Ed. 380. If, however, the deposit is given by the depositor or received by the bank as payment of a debt, a transfer occurs that might be a voidable preference. Mechanics & Metals National Bank v. Ernst, 1913, 231 U.S. 60, 34 S.Ct. 22, 58 L.Ed. 121.

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 17540

ROBERT K. MAYO, H. E. HARPER and JACK C. MURRELL, as Trustees in Bankruptcy of TWIN CITY CONSTRUCTION COMPANY, INC., Bankruptcy
Appellants

versus

PIONEER BANK & TRUST COMPANY
Appellee.

Appeal from the United States District Court for the Western District of Louisiana

(January 20, 1960)

ON PETITION FOR REHEARING

Before JONES, BROWN and WISDOM, Circuit Judges.

PER CURIAM: The Trustees in Bankruptcy of Twin City Construction Company, a Louisiana corporation, sued the Pioneer Bank and Trust Company of Shreveport, Louisiana, to recover $69,145. The Trustees contended that, under Sections 60 (b) and 67 (d) of the Bankruptcy Act, 11 USCA 96(b), 107(d), the bankrupt corporation made three voidable transfers to the Pioneer Bank: (1) one for $50,125; (2) one for $9,000; and (3) one for $10,200. The district judge rejected all three claims of the Trustees. On appeal this Court affirmed

the district court as to the first two claims, and reversed and remanded the case as to the third claim. 270 F.2d 823. The Trustees have applied for a rehearing as to the first two claims; Pioneer Bank has applied for a rehearing as to the third claim. Both applications are denied.

I.

As to the $50,00 claim, the gist of the Trustees' application for a rehearing is that the Court was not justified in disregarding the corporate fiction. They argue that Twin City was chartered as a corporation under the Louisiana Corporation Act, a statute specifically providing that a corporation is a separate legal entity; that our failure to give effect to the corporation as a separate legal entity is unconstitutional and is a refusal to apply the substantive law of Louisiana, in direct contravention of the Erie doctrine. We are not impressed. The corporation law of Louisiana is no different from the corporation law of all the other states in general recognition of a corporation as a separate entity—for purposes of convience and to serve the ends of justice. But when the corporate fiction is a mere simulacrum, an alter ego or business conduit of an individual, it may be disregarded in the interest of securing a just determination of the action. See 13 Am. Jur., Corporations, § ; 1 Fletcher Cyclopedia Corporations § 41 (1931); Latty, The Corporate Entity as a Solvent of Legal Problems, 34 Mich. L. Rev. 599 (1936), to cite just one of many law review articles on the subject; the cases collected in the annotations, 1 ALR 610, 34 ALR 597, 63 ALR 2d 1051; and *Keller v. Haas*, 1943, 202 La. 486, 12 So. 2d 238 and *Linstrom v. Sauer*, 1936, La. App. 166, So. 636, to cite but two Louisiana cases for the general principle involved. Here especially, when the Court is exercising the traditional equity powers of a court of bankruptcy, we will not permit

justice to be frustrated by a fiction that in this case defies common sense and has ceased to have value as a convenient legal tool subserving justice.

Under Section 67d(2)(b), 11 USCA 107d (2) (b), whether a fair consideration has been given for a transfer is "largely a question of fact, as to which considerable latitude must be allowed to the trier of the facts". Under Subsection (d) of Section 67d (2), as distinguished from Subsection (b), there must be "actual intent" to deceive creditors. This too is largely a question of fact. A federal appellate court does not have the same latitude a Louisiana appellate court has in reviewing the facts. We have, however, restudied the entire record. Again we see no error in the district court finding that: (1) there was a fair consideration; (2) "there is no clear and convincing proof that in making the repayment Gray made it with actual intent to defraud the future creditors of Twin City Construction Company."

II.

The $9000 deposited in the checking account of Gray Construction Company represented a transfer of $9000 of $10,000 Twin City borrowed from the Bank. As to this, the Trustees urge that, at least to the extent of the covered overdraft of $4,398.69, the transfer was without consideration and voidable, under Section 67d (2)(a), (b), and (c), 11 USCA 107d(2)(a), (b), and (c). There is no merit to this contention.

In the section of the original opinion dealing with the $9000 claim we did not discuss the question of consideration moving to Twin City, because we looked through the corporate fiction and found that Twin City, Gray Construction Company, and Gray were one. Similarly, the district court found: "The Court finds as a fact that there was a considerable degree of commingling of the

affairs of W. A. Gray Construction Company and Twin City Construction Company. The same office was occupied, the same personnel and central overhead staff was employed, and Gray, in practice, was using the W. A. Gray Construction Company in connection with the Twin City Blytheville contract being carried out . . . In accepting the deposit of $9000.00, in giving the credit, and by paying the items subsequently paid and covering the previously paid items included in the overdraft, the Bank acted in good faith and furnished a fair consideration in the form of such payments and bank clearances . . ." We agree.

The entire $9000 was transferred to W. A. Gray Construction Company, not to the Pioneer Bank; although of course the Bank benefited from the automatic covering of the overdraft. As pointed out by the trial judge in his opinion, "the Bank was merely a depository conduit through which the money passed" from Twin City to W. A. Gray Construction Company. We note that in Civil ction No. 5445 of the Docket of the District Court for the Western District of Louisiana the Trustees of W. A. Gray Construction Company are seeking recovery of the amount of the overdraft on the theory that the $9000 was Gray's money which was improperly paid to the Bank by preference.

Colby v. Riggs National Bank, Ct. App. D.C. 1937, 93 F.2d 183 was cited and discussed by both parties in their original briefs. The trustees state that they cited Colby only as authority for the proposition that under common law rules the bank would be liable unless it could bring itself within one of the statutory exceptions of the Uniform Fiduciaries Act. They contend that in the case at bar Section 6 of the Act gives no protection since it applies only to transfer by check; here the transfer was by a debit memorandum.

We recognize the force of the principle, clearly expressed in the Uniform Fiduciaries Act, that ordinary common law rules apply unless the Bank brings itself within a statutory exception. We reaffirm our holding however that Section 9 of the Uniform Fiduciaries Act,[1] La. R.S. 9:3809, protects the Pioneer Bank as to the entire claim of $9000. As for Colby, and as far as an overdraft is concerned, we feel that the dissent in that case presents the sound view that there is no basis for distinguishing between giving a check to a bank in payment of a personal indebtedness and depositing a check in overdrawn account. Similarly, for purposes of Section 9, we see no diffenence between giving a check to a bank in payment of a personal indebtedness (or depositing a check in an overdraft account) and giving an order, for record purposes cast in the form of a debit memorandum, to a bank to deposit funds in an overdrawn account.

III

As to the $10,020 claim, the Pioneer Bank argues out that the Court erred in holding that the right of the Bank to its pledgee's lien and privilege was not perfected by the payment to the Bank of the $10,020 of the proceeds of the Blytheville contract. The Bank relies on

[1] "If a fiduciary makes a deposit in a bank to his personal credit of checks drawn by him upon an account in his own name as fiduciary, or of checks payable to him as fiduciary, or of checks drawn by him upon an account in the name of his principal if he is empowered to draw checks thereon, or of checks payable to his principal and endorsed by him, if he is empowered to endorse such checks, **or if he otherwise makes a deposit of funds held by him as fiduciary**, the bank receiving such deposit is not bound to inquire whether the fiduciary is committing thereby a breach of his obligation as fiduciary; and the bank is authorized to pay the amount of the deposit or any part thereof upon the personal check of the fiduciary without being liable to the principal, unless, the bank receives the deposit or pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in making such deposit or in drawing such check, or with knowledge of such facts that its action in receiving the deposit or paying the checks amounts to bad faith." L.S.A.-R.S. 9:3809.

Ricotta, Trustee in Bankruptcy of *L. E. Kimball Construction Company v. Burns Coal Building Supply Company*, 2.Cir., 1959, 264 F.2d 749, a case not cited in the original briefs.

We see no reason to alter our opinion. The instant case involves Louisiana law. Under Louisiana law, notice to the debtor is essential to the validity of the pledge. We regard the difference between having a valid pledge prior to payment and not having a valid pledge, because of lack of notice, as something more than a subtle distinction.

Payment alone, as the Trustees in effect contend, should not give an advantage to the Bank, Every voidable preference involves the Bankrupt's recognition of his debt by payment. The question here however is, first, was this a valid pledge prior to payment under Louisiana law; then, did a preference exist and was it voidable under Section 60b, 11 USCA 96b, negating secret liens.

The Ricotta case, we add, concerned materialmen's liens under Section 67b, 11 USCA 107b. A materialman's lien differs substantially from a contractual security transaction in the way it comes into being, in the possibility of its engendering fraud, and in its legislative treatment based on the underlying policies favoring materialmen's liens.

We have considered all the points raised in both petitions for rehearing, whether discussed in this opinion or not.

The petitions for rehearing are DENIED.

L.R.S. 9:3801 DEFINITIONS

For the purposes of this Chapter, unless the context or subject matter otherwise requires:

(1) "Bank" includes any person or association of persons, whether incorporated or not, carrying on the business of banking.

(2) "Fiduciary" includes a trustee under any trust, expressed, implied, resulting or constructive, executor, administrator, guardian, conservator, curator, receiver, trustee in bankruptcy, assignee for the benefit of creditors, partners, agent, officer of a corporation, public or private, public officer, or any other persons acting in a fiduciary capacity for any person, trust or estate.

(3) "Person" includes a corporation, partnership, or other association, or two or more persons having a joint or common interest.

(4) "Principal" includes any person to whom a fiduciary as such owes an obligation.

(5) A thing is done "in good faith" within the meaning of this Chapter when it is in fact done honestly, whether it be done negligently or not.

L.R.S. 9:3802 PAYMENT OR TRANSFER TO FIDUCIARY; RESPONSIBILITY FOR PROPER APPLICATION

A person who is in good faith pays or transfers to a fiduciary any money or other property which the fiduciary as such is authorized to receive, is not responsible for the proper application thereof by the fiduciary; and any right or title acquired from the fiduciary in consideration of such payment or transfer is not invalid in consequence of a misapplication by the fiduciary.

L.R.S. 9:3803 TRANSFER OF STOCKS, BONDS, OR SECURITIES; DUTY TO INQUIRE; LIABILITY

If a fiduciary in whose name are registered any shares of stocks, bonds, or other securities of any corporation, public or private, or company or other association, or of any trust, transfers the same such corporation or company or other association, or any of the managers of the trust, or its or their transfer agent, is not bound to inquire whether the fiduciary is committing a breach of his obligation, as fiduciary in making the transfer or to see to the performance of the fiduciary obligation, and is liable for registering such transfer only where registration of the transfer is made with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in making the transfer, or with knowledge of such facts that the action in registering the transfer amounts to bad faith.

L.R.S. 9:3804 ENDORSEMENT OF NEGOTIABLE INSTRUMENT; DUTY AND LIABILITY OF ENDORSEE

If any negotiable instrument payable or endorsed to a fiduciary as such is endorsed by the fiduciary, or if any negotiable instrument payable or endorsed to his principal is endorsed by a fiduciary empowered to endorse such instrument, on behalf of his principal, the endorsee is not bound to inquire whether the fiduciary is committing a breach of his obligation as fiduciary in endorsing or delivering the instrument and is not chargeable with notice that the fiduciary is committing a breach of his obligation as fiduciary unless he takes the instrument with actual knowledge of such breach or with knowledge of such facts that his action in

taking the instrument amounts to bad faith. If, however, such instrument is transferred by the fiduciary in payment of or as security for a personal debt of the fiduciary to the actual knowledge of the creditor, or is transferred in any transaction known by the transferee to be for the personal benefit of the fiduciary, the creditor or other transferee is liable to the principal if the fiduciary in fact commits a breach of his obligation as fiduciary in transferring the instrument.

L.R.S. 9:3805 PAYEE OF CHECK OR BILL OF EXCHANGE; DUTIES AND LIABILITY

If a check or other bill of exchange is drawn by a fiduciary as such or in the name of his principal by a fiduciary empowered to draw such instrument in the name of his principal, the payee is not bound to inquire whether the fiduciary is committing a breach of his obligation as fiduciary in drawing or delivering the instrument and is not chargeable with notice that the fiduciary is committing a breach of his obligation as fiduciary unless he takes the instrument with actual knowledge of such breach or with knowledge of such facts that his action in taking the instrument amounts to bad faith. If, however, such instrument is payable to a personal creditor of the fiduciary and delivered to the creditor in payment of, or as security for, a personal debt of the fiduciary, to the actual knowledge of the creditor, or is drawn and delivered in any transaction known by the payee to be for the personal benefit of the fiduciary, the creditor or other payee is liable to the principal if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the instrument.

L.R.S. 9:3806 CHECK OR BILL OF EXCHANGE PAYABLE TO, OR TRANSFERRED TO, FIDUCIARY; DUTIES AND LIABILITY OF TRANSFEREE

If a check or other bill of exchange is drawn by a fiduciary as such, or in the name of his principal by a fiduciary empowered to draw such instrument in the name of his principal, payable to the fiduciary personally, or payable to a third person and by him transferred to the fiduciary, and is thereafter transferred by the fiduciary, whether in payment of a personal debt of the fiduciary or other wise, the transferee is not bound to inquire whether the fiduciary is committing a breach of his obligation as fiduciary in transferring the instrument and is not chargeable with notice that the fiduciary is committing a breach of his obligation as fiduciary, unless he takes the instrument with actual knowledge of such breach, or with the knowledge of such facts that his action in taking the instrument amounts to bad faith.

L.R.S. 9:3807 BANK PAYING CHECK; LIABILITY OF

If a deposit is made in a bank to the credit of the fiduciary as such, the bank is authorized to pay amount of the deposit or any part thereof, upon the check of the fiduciary, signed with the name in which such deposit is entered, without being liable to the principal, unless the banks pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in drawing the check, or with the knowledge of such facts that its action in paying the check amounts to bad faith. If, however, such check is payable to the drawee bank and is delivered to it

in payment of, or as, security for a personal debt of the fiduciary to it, the bank is liable to the principal if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the check.

L.R.S. 9:3808 CHECK UPON PRINCIPAL'S ACCOUNT; LIABILITY OF BANK PAYING

If a check is drawn upon the account of his principal in a bank by a fiduciary who is empowered to draw checks upon his principal's account the bank is authorized to pay any such check without being liable to the principal, unless the bank pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in drawing such checks, or with the knowledge of such facts that its action in paying the check amounts to bad faith. If, however, such a check is payable to the drawee bank and is delivered to it in payment of, or as security for, a personal debt of the fiduciary to it, the bank is liable to the principal, if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the check.

L.R.S. 9:3809 DEPOSIT BY FIDUCIARY TO HIS PERSONAL CREDIT; DUTIES AND LIABILITIES OF BANK

If a fiduciary makes a deposit in a bank to his personal credit of checks drawn by him upon an account in his own name as fiduciary, or of checks payable to him as fiduciary, or of checks drawn by him upon an account in the name of his principal if he empowered to draw checks thereon, or of checks payable to his principal and endorsed by him,

if he is empowered to endorse such checks, or if he otherwise makes a deposit of funds held by him as fiduciary, the bank receiving such deposit is not bound to inquire whether the fiduciary is committing thereby a breach of his obligation as fiduciary; and the bank is authorized to pay the amount of the deposit or any part thereof upon the personal check of the fiduciary without being liable to the principal unless, the bank receives the deposit or pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in making such deposit or in drawing such check, or with knowledge of such facts that its action in receiving the deposit or paying the checks amounts to bad faith.

L.R.S. 9:3810 CHECK UPON DEPOSIT IN NAME OF TWO OR MORE TRUSTEES; DUTIES OF BANK AND HOLDER

When a deposit is made in a bank in the name of two or more persons as trustees and a check is drawn upon the trust account, by any trustee or trustees, authorized by the other trustee or trustees to draw checks upon the trust account, neither the payee nor other holder, nor the bank, is bound to inquire whether t is a breach of trust to authorize such trustee or trustees to draw checks upon the trust account, and is not liable unless the circumstances be such that the action of the payee or other holder or the bank amounts to bad faith.

L.R.S. 9:3811 TRANSACTIONS PRIOR TO JANUARY 1, 1925

The provisions of this Chapter shall not apply to transactions taking place prior to January 1, 1925.

L.R.S. 9:3812 CASES NOT PROVIDED FOR; RULES APPLICABLE

In any case not provided for in this Chapter the rules of law and equity, including the law merchant and those rules of law and equity relating to trusts, agency, negotiable instruments and banking, shall continue to apply.

L.R.S. 9:3813 UNIFORM CONSTRUCTION

This Chapter shall be so interpreted and construed as to effectuate its general purpose to make uniform the law of those states which enact it.

L.R.S. 9:3814 SHORT TITLE

This Chapter may be cited as the Uniform Fiduciary law.

L.R.S. 7:185 DEFINITION OF CHECK; PROVISIONS APPLICABLE

A check is a bill of exchange drawn on a bank payable on demand. Except as herein otherwise provided the provisions of this Chapter applicable to a bill of exchange on demand apply to a check.

L.R.S. 7:126 BILL OF EXCHANGE DEFINED

A bill of exchange is an unconditional order in writing addressed by one person to another, signed by a person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer.